

**Los Angeles
County
Metropolitan
Transportation
Authority:**

**Planning and Budgeting of Its Operations
and Bus Plan Need Improvement**

August 1996
96114

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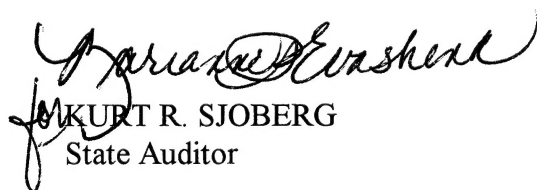
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The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report concerning the effects of the Los Angeles County Metropolitan Transportation Authority's (MTA) long-range planning, annual budgeting, debt service, and bus service levels on its financial viability and solvency. This report concludes that the MTA's long-range plan appears flawed and, as a result, may contain a \$1.3 billion shortfall. In addition, the MTA's plan to reduce its projected \$14 million operating deficit for fiscal year 1995-96 appeared unrealistic and included strategies to defer or reallocate costs. Further, the MTA's fiscal year 1996-97 budget anticipated significant cost reductions that may not materialize. Finally, the MTA has yet to fully develop its Bus System Improvement Plan.

Respectfully submitted,


KURT R. SJOBERG
State Auditor

Enclosure

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Summary

Audit Highlights . . .

We found that:

- ☑ *The MTA's \$72.5 billion long-range plan may contain a \$1.3 billion shortfall due to an optimistic inflation forecast and anticipated cost efficiencies unlikely to materialize.*
- ☑ *The MTA planned to reduce its projected \$14 million operating deficit for fiscal year 1995-96, but its plan:*
 - *Did not appear realistic, and*
 - *Either defers or reallocates costs.*
- ☑ *Its fiscal year 1996-97 budget includes significant operating cost reductions that may not be realized.*
- ☑ *The MTA has yet to fully develop the Bus System Improvement Plan adopted almost five months ago.*

Results in Brief

Established in 1993 by state law, the Los Angeles County Metropolitan Transportation Authority (MTA) is the second largest public transportation agency in the country. The MTA coordinates the operation of all public transportation services within Los Angeles County (county), including long-range regional transportation planning, light and heavy commuter rail systems, and bus service within the MTA's service area in the county and portions of Orange and Ventura counties.

Our review of the MTA focused on the long-range planning and financial status of the MTA to determine its financial viability and bus service levels.

According to our review, certain aspects of the MTA's \$72.5 billion long-range plan appear flawed. As a result, it may contain a \$1.3 billion shortfall. Specifically, the plan:

- Contains an optimistic forecast of inflation; and
- Anticipates cost efficiencies from bus operations that are not likely to materialize.

Consequently, the scheduled delivery of planned transportation projects may be postponed, and the delays may cause increased construction costs that the current plan does not reflect.

In addition, our review indicated that the MTA's projected financial results for fiscal year 1995-96 exceeded its revised operating budget by approximately \$14 million. Our review of revenue and expense trends indicated that the MTA's deficit reduction plan:

- Did not appear realistic; and
- Included some strategies that either defer operating costs to future periods or reallocate them to nonoperating funds.

However, subsequent to our review, the MTA asserted that, when final financial information is available for fiscal year 1995-96, the deficit will have been eliminated.

Further, when it formulated its fiscal year 1996-97 budget, the MTA anticipated significant operating cost reductions that are unlikely to materialize. If the cost reductions do not occur, the MTA will incur an operating deficit greater than that of the previous fiscal year when the carryover deficit from fiscal year 1995-96 is considered. The MTA also considered additional construction project costs totaling \$123 million in its fiscal year 1996-97 budget, but it has yet to reflect the revenues to pay for over \$61 million of these costs in the long-range plan.

The MTA's outstanding long-term debt approximated \$3.1 billion as of June 30, 1996, with annual debt service requirements of approximately \$230 million. The MTA's plan to manage its debt includes the issuance of bonds totaling more than \$2 billion over the next several years. The debt management plan complies with prescribed limits imposed by its trustees and with a self-imposed policy related to refunding bonds.

Although it adopted a Bus System Improvement Plan almost five months ago, the MTA has yet to develop some of this plan's key components. Specifically, our review noted that:

- Cost estimates are still unavailable for some projects;
- A few projects have no set time lines for implementation; and
- The plan is not fully funded.

Agency Comments

The MTA disagrees with the conclusions in our report concerning its long-range plan, its budgeting process, and its efforts to improve its bus system. However, the MTA bases much of its disagreement on information that was not made available during the time of our review. Therefore, we could not audit it for its veracity.

Introduction

Background

The Los Angeles County Metropolitan Transportation Authority (MTA) was established in 1993 by state law as the result of the merger of the Los Angeles County Transportation Commission (commission) and the Southern California Rapid Transit District. The MTA is governed by a 14-member board of directors (board) consisting of 5 county supervisors, the mayor of Los Angeles, 5 city council members or mayors, 2 public members, and a nonvoting member appointed by the governor. A chief executive officer manages the MTA to provide leadership and fulfill the mission of the board.

The MTA, which is the second largest public transportation agency in the United States, coordinates the operation of all public transportation services within Los Angeles County (county). Its operations include:

- Long-range regional transportation planning;
- Planning, developing, constructing, and operating light and heavy commuter rail systems; and
- Providing bus service within its service area in the county and to portions of Orange and Ventura counties.

As the principal transportation agency in the county, the MTA establishes the county's strategic long-range transportation plan. The commission adopted a plan in 1992, prior to the creation of the MTA, that projected spending of \$183 billion over 30 years to achieve the commission's transportation goals. However, because of such events as the recession and state funding shortfalls, the plan was subsequently scaled down. In 1995, the board adopted a 20-year long-range plan. The goal of this plan is to develop a system that better serves the needs of transit riders while improving public transportation services, reducing traffic congestion, and improving air quality. The MTA projects that the plan will cost approximately \$72.5 billion over the 20-year period.

The MTA is also responsible for planning, developing, and constructing rail systems to serve the county, and it currently operates three metropolitan rail lines. The Metro Blue Line light rail system, which was completed in 1990, covers 22 miles between the cities of Los Angeles and Long Beach. Another 14-mile segment of the Metro Blue Line, from Union Station in Los Angeles to Pasadena, is under construction and is scheduled for completion in 2001. The Metro Green Line, a 20-mile light rail line that opened in 1995, runs between Norwalk and El Segundo and also connects with the Metro Blue Line. The MTA is currently designing and constructing in three phases the Metro Red Line, a 23-mile subway system, that will eventually run through Hollywood, the San Fernando Valley, and East Los Angeles. The MTA completed construction in 1993 on the first phase of 4.4 miles. A portion of the 6.7-mile second phase was completed in July 1996, and the MTA expects to complete the remainder by 1999. The third phase, which includes three more segments, is not scheduled for completion until after 2000.

The MTA serves as the main bus service for the county. It operates a fleet of 2,200 buses over a route system of approximately 3,800 miles to provide transportation for approximately 1.2 million passengers each weekday. In response to concerns about the MTA's declining bus service and ridership, the board adopted a plan in March 1996 to improve the MTA's bus system that incorporates more than 30 projects and programs to be completed over the next several years.

The MTA receives funding for its operations from a variety of sources, including local, state, and federal revenues. Proposition A and Proposition C, which were approved by the county's voters, each impose a one-half percent sales and use tax and generate 37 percent of the MTA's budgeted annual revenues. The MTA also receives state funds, such as gasoline tax revenues and sales and use tax revenues, to pay for such activities as transportation planning, transit operations, and rail projects. Additionally, the federal government provides funding for transit operations and capital projects, including the Metro Red Line. Finally, bus and transit riders contribute about 5 percent of budgeted annual revenues through farebox revenues.

The MTA and its predecessors issued long-term debt to assist in the construction of the various rail systems and to purchase equipment such as buses and rail cars. The long-term debt is secured by various revenue sources, including Proposition A

and Proposition C sales and use taxes, farebox revenues, and federal and state grants. As of June 30, 1996, long-term debt totals approximately \$3.1 billion.

Funds Transferred to Los Angeles County

In October 1995, the governor approved legislation authorizing a transfer of MTA funds to assist the county in achieving a balanced budget in fiscal year 1995-96. These funds come from one-quarter percent Transportation Development Act (TDA) county sales and use tax revenues that otherwise would be allocated from the county's local transportation fund to the MTA for its bus operations. The county transferred \$50 million of TDA sales and use tax revenues to its general fund, making three monthly transfers of \$15 million each beginning in March 1996 and a final transfer of \$5 million in June 1996. Because the legislation also required that the MTA not reduce its bus service and operations as a result of the transfer of funds, the MTA transferred \$50 million of its discretionary Proposition C sales and use tax revenues to fund its current bus service and operations and thus offset the effect of the transfer.

Seismic Retrofit Bond Act of 1996

Chapter 310, Statutes of 1995, provide the legislative authority for the Seismic Retrofit Bond Act of 1996, which was approved by the voters in March 1996. This statute includes a requirement that no funds become available for any mass transit guideways in Los Angeles County until the California Transportation Commission (CTC) finds that the MTA has adopted a specific plan which guarantees that the MTA can reduce its debt, achieve solvency, and restore affordable bus service for its transit customers.

Scope and Methodology

The purpose of this audit was to obtain detailed information about the financial status of the MTA to assist the CTC in determining the MTA's financial viability and service levels as required by the Seismic Retrofit Bond Act of 1996. Specifically, we reviewed and evaluated the laws, rules, and regulations relevant to the MTA and its transportation programs; reviewed the minutes of board meetings from January 1995 to July 1996; and interviewed MTA personnel.

To assess the MTA's long-term plans, we examined its long-range transportation plan, including the technical appendices, and the February 1996 update to the plan. In addition, we reviewed the August 1994 and August 1995 economic and demographic forecasts for Los Angeles County that the University of California at Los Angeles (UCLA) had prepared and that the MTA had used in developing the plan and the update. Finally, we reviewed a study issued by another organization that analyzed the MTA's long-range transportation plans.

To review and assess its fiscal year 1995-96 financial statements, we examined the MTA's unaudited financial statements as of December 31, 1995. We analyzed for reasonableness the MTA's actual annualized projections for operating revenues and expenses as of December 31, 1995, and recalculated those projections for material account balances. We also reviewed available subsequent financial information through February 29, 1996. Additionally, we examined the MTA's budget-to-actual variance analysis and compared its actual annualized projections as of December 31, 1995, to its fiscal year 1995-96 revised budget. Further, we examined the MTA's analysis of its projected deficit as of September 30, 1995, and compared the deficit projections to the MTA's projections as of December 31, 1995. Finally, we identified any significant fluctuations and determined the reasons for these differences.

To assess the MTA's financial viability and solvency, we examined its budgets for fiscal years 1995-96 and 1996-97. In addition, we reviewed and determined the reasonableness of the MTA's budget assumptions and supporting schedules for revenues and expenses. We also interviewed MTA management to confirm our understanding of the budgetary approach and the revenue and expense assumptions. Further, we examined the MTA's executive rail program status report as of May 1996, the corresponding project manager status reports for the various rail construction projects, and policies and procedures for the MTA's capital budgeting and cost forecasting. Finally, we reviewed a report issued in May 1996 by the U.S. General Accounting Office that analyzed construction cost overruns on the Metro Red Line.

To review and assess the MTA's plan to reduce debt and its effect on solvency, we examined official statements for outstanding debt service. In addition, we examined certifications prepared by the MTA's financial advisors stating that the MTA had met its required debt coverage ratio and we examined cost-benefit analyses and recommendations for issuance of bonds prepared by the MTA and its

financial advisors. We also examined pricing data prepared by financial advisors regarding the cost savings achieved by the MTA when it issued refunding bonds. Finally, we calculated for fiscal year 1995-96 the percentage of annual debt service expenditures to the MTA's annualized operating expenditures.

To review and assess the MTA's specific plan to restore bus service for the population it serves, we examined the Bus System Improvement Plan adopted by the board in March 1996 and identified the key components of the plan. In addition, we examined supporting documents for the key components and identified the associated costs and time lines, when available, for those components. Finally, we examined the outline for the bus system workshop held in September 1995 and the bus system performance indicators for the periods for which they were available.

Chapter 1

The Los Angeles County Metropolitan Transportation Authority's Long-Range Plan Has Flaws

Chapter Summary

The Los Angeles County Metropolitan Transportation Authority (MTA) developed a long-range plan in March 1995 to meet the future transportation needs of Los Angeles County (county). The development process included identifying existing projects and programs as the basis for the plan and establishing a list of additional projects and programs that would enhance the transportation system. To analyze each new project, the MTA used a computer simulation model and developed planning scenarios that included different combinations of bus, rail, and highway projects. The MTA's board of directors (board) then adopted a plan totaling \$72.5 billion in expenditures over a 20-year period.

However, in its first annual update of the plan, the MTA lowered its projected revenues by \$3.6 billion (5 percent) over the 20-year life of the plan because of a drop in anticipated revenues and revisions in its forecasting assumptions. Specifically, the MTA expects a \$2 billion reduction in farebox revenues, and it projects an additional \$686 million federal funding decrease. In addition, other federal funding decreased by \$1.1 billion because of a change in one of its forecasting methods and in its inflation rate assumption. To add to the problem, the MTA has projected net cost reductions of only \$3.3 billion, and these consist primarily of decreases in bus and rail operating expenditures, leaving an anticipated revenue gap of \$351 million over the 20-year period. Furthermore, \$927 million of those projected cost savings resulted from the MTA using a revised forecasting assumption, and the MTA had based another \$1.1 billion in projected cost savings on a flawed assumption, leaving only \$1.2 billion in true cost savings.


In other words, if we delete from the MTA's long-range plan the effects of the revised forecasting method and the flawed assumption, we can see that the MTA is facing a funding gap of \$1.3 billion. Even if one of the MTA's assumptions regarding a

sustained lower level of inflation proves correct, the revisions to the long-range plan will still result in a funding shortfall of more than \$755 million over the life of the plan. Consequently, the scheduled delivery of transportation projects and service may be delayed, resulting in even higher construction costs. Thus, even though its long-range plan is only in its early years, the MTA needs to make significant revisions to meet future demands.


The MTA's Long-Range Plan Has Multiple Components

The mission of the MTA is to design, construct, and operate a safe, reliable, affordable, and efficient transportation system that increases mobility, relieves congestion, and improves air quality to meet the needs of all county residents. To achieve this mission, the MTA developed a long-range plan that has as its stated goals:

- Providing transportation alternatives capable of meeting the continuing need for personal mobility and the movement of goods;
- Reducing costs and increasing cost efficiency without compromising services; and
- Continuing the pursuit of improved air quality.




Despite a \$55.5 billion investment, by the end of the MTA's 20-year plan an additional 1.5 million single occupant vehicles will be on county streets.




The development process for the plan included identifying as the base plan existing projects and programs currently under construction or fully funded, estimating the amount of revenues available to fund transportation activities other than existing projects, and establishing a list of additional projects and programs funded with uncommitted projected revenues that would enhance the transportation system. The base plan, which included bus and rail capital projects, and bus and rail operations and maintenance, was projected to cost \$55.5 billion over the 20-year life of the plan. Despite this \$55.5 billion investment, however, the MTA anticipated that users of the transportation system will experience higher levels of congestion and lower levels of mobility over the next 20 years because projected increases in the transportation system do not keep up with projected increases in population and employment. Without material changes to the base plan transportation system, the MTA estimated that by the conclusion of the 20-year life of the plan an additional 1.5 million single occupant commuter vehicles will be on the county streets.

To meet the growth challenges, the MTA considered a variety of new projects to add to the base plan. To determine the best mix of projects to augment the base plan, the MTA used a computer simulation model to analyze each new project and develop planning scenarios that included different combinations of bus, rail, and highway projects.



The MTA evaluated three planning scenarios and selected one that, according to a computer model, provided the best mix of projects.



In evaluating the best alternatives for the long-range plan, the MTA considered each project for its contribution to mobility and air quality as well as its cost-effectiveness in achieving those objectives.

The MTA evaluated three planning scenarios to measure the benefits of combinations of rail, bus, highway, and carpooling projects. The primary differences between the scenarios were offsetting increases of bus service and rail extensions within the constraints of available funding:

- Scenario 1—Add 300 buses to the base plan for a peak fleet of 2,871 buses, construct one new rail line, extend two existing rail lines, and construct additional carpooling lanes.
- Scenario 2—Add 627 buses to the base plan's peak bus fleet and construct one new rail line.
- Scenario 3—Add 500 buses to the base plan's peak bus fleet, construct one new rail line, and extend one existing rail line.

In March 1995, the board selected Scenario 1 as its preferred augmentation of the base plan because, according to the computer model, it provided the best mix of projects to create an overall improvement in travel speed and air quality, and it was cost-effective.

As shown in Table 1, the long-range plan adopted by the board projects the following revenues and expenses:

Table 1

***MTA 20-Year Long-Range Plan:
Projected Revenues and Costs
(In Millions)***

	Amount
Revenues	
Proposition A and Proposition C sales tax revenues*	\$32,902.7
Transportation Development Act sales tax revenue	6,550.1
Bus and rail farebox revenues	9,970.4
Federal funding	12,425.8
Other state and local sources	10,627.5
Total Projected Revenues	\$72,476.5
Costs	
Rail capital projects	\$15,390.9
Bus capital projects	3,707.6
Rail operations	5,376.0
Bus operations	21,853.2
Funding provided to local cities and counties	5,398.1
Capital funding for carpool lanes, highway access improvements, and transportation management programs	12,400.3
Other expenses (reserves, administration, and financing)	8,350.4
Total Projected Costs	\$72,476.5

*Part of this revenue includes bond proceeds secured by local sales tax revenue.


***The Long-Range Plan Contains
an Optimistic Forecast, and One
of Its Assumptions Is Flawed***

Our review of the MTA's long-range plan and its first-year financial update issued in February 1996 identified some concerns about the MTA's plan and forecast. In the first year of the plan's implementation, the MTA revised its revenue forecast downward from \$72.5 billion to \$68.9 billion, reflecting a \$3.6 billion (5 percent) decrease in projected funding over the life of the plan. As shown in Table 2, the change in projected revenues results from revising revenues downward coming from fareboxes and the federal government and from changes in the MTA's forecasting assumptions. Specifically, pending litigation prohibiting the MTA from fully implementing planned changes


to its fare structure caused the lowering of projections by \$1.966 billion in farebox revenues for bus operations. Further, the phasing out of certain federal funds for bus operations caused an additional lowering of projections by more than \$686 million.

Moreover, the MTA changed one of its significant assumptions in projecting inflation that directly affects federal capital transit improvement funds for new rail projects. In developing its long-range plan, the MTA initially assumed for its operating revenues and costs that inflation would average 3.99 percent annually over the life of the plan. This rate was based on a 1994 long-term forecast for the county prepared by the UCLA Business Forecasting Project that estimates, among other things, average inflation rates for a period of 20 years into the future. The MTA also assumed an average annual inflation rate of 3.28 percent for its capital projects over the life of the plan. This rate was based on the relationship of the Construction Cost Index to the Consumer Price Index as forecast by UCLA.

However, the MTA later used the 1995 UCLA forecast in preparing its financial update for its long-range plan, which projected a downward trend for inflation. Therefore, the financial update assumes lower inflation rates of 3.26 and 2.68 percent for its operations and capital projects, respectively. After adjusting the inflation rate assumption for capital projects down from 3.28 to 2.68 percent, the MTA projected that rail capital transit improvement funds will decrease by \$386 million.



In summary, actual dollars lost over the plan's life will be \$2.5 billion, while changes in the projected inflation rate and forecasting method will bring an additional \$1.1 billion decrease.



In addition, because of a revision in the forecasting methodology used by the MTA, federal transit capital funds primarily used for bus replacement, maintenance, and expansion and federal Congestion Mitigation and Air Quality Improvement program funding for projects contributing to the attainment of national air quality standards were reduced by \$390.6 million and \$324.5 million, respectively. Finally, the MTA raised by a net amount of \$131 million its estimate of revenues coming from a combination of other sources, including local sales tax, state funds, other federal funds, and miscellaneous other revenues. In summary, according to the update, actual dollars lost over the remaining life of the plan will be \$2.5 billion, while changes in the projected inflation rate and forecasting methodology used by the MTA will bring about a decrease of another \$1.1 billion.

Table 2

**MTA 20-Year Long-Range Plan Update:
Projected Revenue
(In Millions)**

Revenue Source	Revenues Per Long-Range Plan	Revenues Per 1996 Update	Change in Revenues
<u>Adjustments Due to Changes in Funding</u>			
Farebox revenue	\$ 8,529.6	\$ 6,563.7	\$(1,965.9)
Federal funding for bus operations	816.9	130.6	(686.3)
Other revenues	54,607.4	54,738.4	131.0
Subtotal	63,953.9	61,432.7	(2,521.2)
<u>Adjustments Due to Changes in Assumptions</u>			
Federal rail capital transit improvement funds	4,826.8	4,440.4	(386.4)
Federal transit capital funds	2,277.1	1,886.5	(390.6)
Congestion Mitigation and Air Quality Improvement program federal funds	1,418.7	1,094.2	(324.5)
Subtotal	8,522.6	7,421.1	(1,101.5)
Total	\$72,476.5	\$68,853.8	\$(3,622.7)

***One Assumption for Reducing
Costs Had Flaws***

The MTA has acted to mitigate the projected decrease in plan revenues through reductions in the projected costs of rail and bus operations, capital projects, and funding for local cities and counties. However, as shown in Table 3, the projected cost reductions total only \$3.3 billion, leaving a funding gap of approximately \$351 million for planned projects. Further, the update indicates that calculations for \$927 million in projected cost reductions coming from rail capital and rail operations result mainly from the assumption of a lower inflation rate based on a new forecast. Moreover, an additional \$398 million in projected cost savings depends primarily on the MTA's increasing the amount of time between trains, an action that could effectively lower the level of rider service. In addition, the MTA's financial update estimates cost savings totaling \$2.3 billion, of which \$2 billion reflects the 20-year projected cost efficiencies anticipated from bus operations and maintenance. However, the assumption used by the MTA in projecting these efficiencies is flawed.


Table 3

**MTA 20-Year Long-Range Plan:
Projected Changes in Revenues and
Costs With Assumptions Held at the
Level of the Original Long-Range Plan
(In Millions)**


Nature of Projected Change	Projected Decrease or Increase	Reduction Due to Change in Inflation Rate	Reduction Due to Change in Methodology	Reduction Due to Flaw in Assumption	Changes in Revenues and Costs
Changes in Revenues					
Decrease in farebox revenue	\$(1,965.9)	\$ 0.0	\$ 0.0	\$ 0.0	\$(1,965.9)
Decrease in federal funding for bus operations	(686.3)	0.0	0.0	0.0	(686.3)
Increase in other revenues	131.0	0.0	0.0	0.0	131.0
Decrease in federal rail capital transit improvement funds	(386.4)	386.4	0.0	0.0	0.0
Decrease in federal capital transit funds	(390.6)	0.0	390.6	0.0	0.0
Decrease in federal CMAQ* funds	(324.5)	0.0	324.5	0.0	0.0
Subtotal	(3,622.7)	386.4	715.1	0.0	(2,521.2)
Changes in Costs					
Decrease in costs due to change in assumption about inflation rate**	927.0	(927.0)	0.0	0.0	0.0
Decrease in local return program costs	111.4	0.0	0.0	0.0	111.4
Decrease in costs due to increase in the amount of time between trains	398.0	0.0	0.0	0.0	398.0
Decrease in operating and maintenance costs due to efficiencies	2,331.1	0.0	0.0	(1,120.3)	1,210.8
Increase in spending for carpool lanes and major arterial improvements	(210.9)	0.0	0.0	0.0	(210.9)
Increase in financing and administrative costs	(284.4)	0.0	0.0	0.0	(284.4)
Subtotal	3,272.2	(927.0)	0.0	(1,120.3)	1,224.9
Revenue Shortfall	\$ (350.5)	\$(540.6)	\$715.1	\$(1,120.3)	\$(1,296.3)

*Congestion Mitigation and Air Quality Improvement program

**Includes inflation effect on rail capital and rail operations





By ignoring the \$20 million shortfall in budgeted cost reductions, the MTA has overstated by more than \$1.1 billion its projected total cost savings.



The MTA's manager of long-range planning stated that, in the financial update, estimated cost efficiencies for bus operations were based on a projected cost reduction of \$36.5 million contained in the MTA's fiscal year 1995-96 budget. The MTA then adjusted for inflation this annual reduction and projected the cost efficiencies out over the 20-year life of the plan. Of the \$36.5 million in budgeted fiscal year 1995-96 cost efficiencies, \$20 million was predicated on a cost reduction strategy to reduce operator salaries and fringe benefits through the elimination of 272 positions and to reorganize the MTA bus operations into regional divisions. However, as discussed more fully in Chapter 2, these savings were never realized. Although the fiscal year 1995-96 budget cost reduction strategies were not met, the MTA did not revise its projection of cost savings from bus operations accordingly. We believe that, by ignoring the \$20 million shortfall in its budgeted cost reductions, the MTA has overstated by more than \$1.1 billion its projected total cost savings of \$2.3 billion from bus operations. When we include in our calculations the \$20 million shortfall, we arrive at a revised cost savings of \$1.2 billion over the 20-year life of the plan.

Further, because the MTA based the figures for its long-range plan on assumptions, as demonstrated by the differences between UCLA's 1994 and 1995 business forecasts for operating and capital project inflation rates, the figures are subject to future unknown factors that could cause revenues and costs to fluctuate substantially. The change between 1994 and 1995 forecasts resulted in the MTA changing an assumption and making a \$927 million downward adjustment in the 20-year forecast of costs. In contrast to this lowering of the projected inflation rate, the 1995 UCLA forecast shows that the actual average inflation factor for the 15 years preceding the plan year (1981 to 1995) was 4.22 percent. Therefore, if the future rate of inflation were to return to previous levels, costs over the 20-year period could increase by millions of dollars. Furthermore, even if the MTA's assumption regarding a sustained lower level of inflation proves correct, the revisions to the long-range plan still result in a funding shortfall of more than \$755 million over the life of the plan.

In summary, of the approximately \$3.3 billion in the MTA's projected net cost reductions, only \$1,224.9 million can be tied to real dollars, obtained partially through increasing the time between trains that could result in a lower level of rider service. On the other hand, \$927 million of projected cost reductions is due to the MTA changing the inflation rate assumption, and more than \$1.1 billion is based on anticipated cost efficiencies that will not materialize. When the effects of both the flaw and changes in assumptions are eliminated,


*When the effects of
unmaterialized cost
efficiencies and changes
in assumptions are
eliminated, the MTA's
plan results in a
\$1.3 billion shortfall.*


the net revenue decrease of \$2.5 billion exceeds the MTA's net projected cost reductions of \$1.2 billion and results in a \$1.3 billion shortfall in real dollars over the life of the plan. Such a revenue shortfall could cause delays in the scheduled delivery of planned transit projects and result in an increase in construction costs that the current plan does not reflect.

Finally, the MTA's long-range plan provides for a \$720 million contingency reserve for use in the second decade of the plan to offset any future reductions in federal funding, increases in construction costs, and reductions in planned farebox revenue. In light of the MTA's revised estimate of a \$3.6 billion decline projected in the total plan revenues of \$72.5 billion in just the first year of the 20-year plan, it is likely that the contingency reserve is not adequate.

Conclusion

The MTA's long-range plan contains an optimistic forecast and a flawed assumption that could cause delays in the scheduled delivery of planned transit projects and result in an increase in construction costs. For example, in its original plan, the MTA projected bus farebox revenues predicated on the MTA's implementing changes in its fare structure that pending litigation has already prevented. As a result, the MTA revised its farebox revenue projections downward by approximately \$2 billion over the 20-year life of the plan. Further, the MTA determined that certain federal funding for bus operations anticipated in the long-range plan will be phased out in the future. This change in funding expectation resulted in the MTA's calculating a decrease of \$686 million in revenue over the life of the plan.

In an effort to mitigate the loss of revenues, the MTA revised its projections of operating costs based on planned efficiencies in operations and maintenance that projected \$2.3 billion in cost reductions over the 20-year life of the plan. However, these anticipated cost savings are overstated by \$1.1 billion because the MTA used a flawed assumption when calculating its estimated savings. In addition, the MTA has revised its interest rate assumption downward based on a recent forecast by the UCLA Business Forecasting Project. This revision included a \$927 million lowering of projected costs and a \$386.4 million anticipated decrease in federal revenues. However, if the future rate of inflation were to return to the levels experienced in previous periods, the net savings from the inflation rate adjustment could be reversed.

Finally, because the MTA has revised its estimate of revenues downward by \$3.6 billion, from \$72.5 billion to \$68.9 billion, in just the first year, it is likely that the 20-year plan's contingency reserve totaling \$720 million for future revenue shortfalls is inadequate.

Chapter 2

The MTA's Budgeting Process Needs Improvement

Chapter Summary

Because its efforts relied on one-time revenue and significant staff reductions, the Los Angeles County Metropolitan Transportation Authority (MTA) was able to balance its fiscal year 1994-95 budget. However, the MTA's annualized financial results for fiscal year 1995-96 resulted in a budget shortfall. As of August 1, 1996, the MTA's actual financial data for the last half of fiscal year 1995-96 was not available. However, if we use the MTA's actual costs of transit operations recorded during the first half of fiscal year 1995-96 and annualize these costs for the last part of the fiscal year, the resulting figures indicate that the MTA has exceeded its revised operating budget by approximately \$14 million at June 30, 1996. The MTA expected to overcome this budget deficit by reducing the number of operators and mechanics on its payroll, making certain accounting adjustments that reduced the reserve accounts for its workers' compensation and employee vacation liabilities which the MTA assumed were excessive, and lowering the MTA's capitalization policy requirements for some of its assets.

However, based on the revenue and expense trends we reviewed for fiscal year 1995-96, it appears that the MTA's plan to reduce its projected mid-year deficit to zero by year-end was not realistic. For example, our review of the MTA's deficit reduction plan indicates that many of the MTA's cost reduction strategies have involved changing its accounting methods, such as the method used to capitalize some of its assets, and reducing its operating expenses by removing certain expenses from its operating budget and reclassifying them as expenses of a nonoperating fund. Consequently, the effect of much of the MTA's deficit reduction plan was to defer current operating costs to future periods and allocate current operating expenditures to nonoperating funds to eliminate the deficit.



We believe that some of the assumptions used by the MTA in developing its fiscal year 1996-97 budget may be too optimistic and certain predicted cost changes may fail to materialize. If so, the MTA can expect an operating deficit greater than that of the previous fiscal year, particularly if the deficit encompasses

the carryover deficit from fiscal year 1995-96. Specifically, the budget anticipates significant cost reductions, such as reducing operator and maintenance employee overtime, that may not materialize.

Finally, during a review of its capital budget for fiscal year 1995-96, the MTA identified approximately \$123 million in unbudgeted cost overruns relating to one of its rail projects. However, while the MTA considered these additional project costs when it formulated its fiscal year 1996-97 budget, it has yet to provide a means to pay for half of these costs in its long-range plan. As a result, the MTA's long-range plan does not reflect the revenues planned to pay for more than \$61 million of the \$123 million in additional costs.

***Fiscal Year 1995-96 Annualized
Actual Expenses for the MTA's Operations
Are \$14 Million Over Budget***

As part of our audit, we were asked to review the MTA's budgets for fiscal years 1995-96 and 1996-97 and to assess its financial viability and solvency. Our review indicates that the annualized cost of the MTA's bus and rail operations will exceed its revised budget by nearly \$14 million in fiscal year 1995-96. Our financial information is estimated because the MTA is in the midst of a transition to a new financial information system, and actual revenue and expense data representing the MTA's results of operations were only available through December 31, 1995. Therefore, we annualized the year-to-date actual results through June 30, 1996. We then compared for reasonableness the annualized financial results against the projections the MTA made as of December 31, 1995. Having ensured that the annualized results we computed were reasonable, we then assessed them against the MTA's fiscal year 1995-96 revised operating budget. The MTA's management revised the original approved budget to reflect two significant changes, a \$7 million revenue reduction in federal operating assistance and a \$4 million expense increase based on a newly implemented employee fringe benefit cost allocation plan.


The MTA faced significant reductions in operating subsidies and assumed overly aggressive cost reduction strategies.


During fiscal year 1995-96, the MTA faced significant reductions in its operating subsidies as a result of federal funding cutbacks. In addition, according to the MTA's chief financial officer, the fiscal year 1995-96 operating budget assumed overly aggressive cost reduction strategies that the MTA had not met.



The MTA's revised fiscal year 1995-96 budgeted expenditures for its transit operations totaled approximately \$659 million. The MTA's operations budget comprised approximately 21 percent of the \$3 billion total budgeted expenses, while its capital projects budget comprised \$1.1 billion (37 percent) of total budgeted expenses. The MTA budgeted revenues totaling approximately \$2.9 billion to fund its planned expenditures.

Table 4 shows that the MTA's annualized operating revenues for fiscal year 1995-96 have fluctuated slightly, while its operating expenditures have increased significantly over the amount the MTA budgeted. For example, farebox revenues, which comprised approximately \$213 million of budgeted annual operating revenues, fell \$2 million short of the amount the MTA budgeted. Also, although the MTA projected subsidies to increase by \$3 million, the results of our review indicate that this revenue increase was due to a change in the MTA's accounting method used for its workers' compensation financing and not for any actual additional revenues.

Table 4

***Annualized Actual Revenues and
Expenditures Versus Budget
Fiscal Year 1995-96
(In Millions)***

	Fiscal Year 1995-96			
	Annualized Actual Data as of 6/30/96	Revised Budget Data as of 6/30/96	Variance	
			Amount	Percent
<u>Revenues by Source</u>				
Farebox revenues	\$211	\$213	\$ (2)	-0.9%
Subsidies	433	430	3	0.7
Other operating revenues	15	14	1	7.1
Total Operating Revenues	\$659	\$657	\$ 2	0.3%
<u>Operating Expenditures</u>				
Operator wages and overtime	\$160	\$140	\$20	14.3%
Fringe benefits	162	152	10	6.6
Materials and supplies	45	37	8	21.6
Debt service principal	0	7	(7)	-100.0
Interest expense	4	16	(12)	-75.0
Casualty and liability insurance	31	28	3	10.7
Other expenditures	271	279	(8)	-2.9
Total Operating Expenses	\$673	\$659	\$14	2.1%


The 1995-96 fiscal year budget was predicated on a cost reduction strategy to lower operator salaries and benefits by \$20 million that was not realized.


Annualized operating expenditures exceeded the amount the MTA budgeted by approximately \$14 million due to a variety of factors. For example, based on the MTA's computations, total annualized operator wages and overtime exceeded the budgeted amount by approximately \$20 million. The fiscal year 1995-96 budget was predicated on an aggressive cost reduction strategy to lower operator salaries and fringe benefits by \$20 million. The MTA intended to accomplish this strategy by reorganizing the MTA's bus operations into regional divisions and thus eliminating 272 positions. However, these reductions were never realized. In addition, the MTA spent approximately \$8 million more for materials and supplies than it had budgeted.

By September 1995, the MTA was projecting a fiscal year-end shortfall of \$28 million. Since then, it has reduced its projected deficit primarily by transferring the debt service costs for its certificates of participation from the enterprise fund, which accounts for the MTA's operating budget, to its debt service fund. As a result, in December 1995, the MTA was able to halve its projected operating deficit to \$14 million. At that time, the MTA expected projected cost savings to offset the remaining shortfall. For example, the MTA implemented strategies to lower its salaries and wages through the end of the fiscal year, and it made significant changes in its budgetary approach by adjusting its administrative cost allocation plan between the MTA's funds to reflect actual rather than estimated costs. The MTA estimated that these two factors alone would result in cost savings of \$13 million in the six months remaining until the end of the fiscal year. As a result, the MTA anticipated that its fiscal year 1995-96 operating balance would be \$0.

However, according to the revenue and expense trends we reviewed for fiscal year 1995-96, the MTA's plan to reduce its projected deficit to zero by year-end appears to have been unrealistic. Specifically, some of the MTA's most significant cost reduction strategies employed to date have involved changes in the MTA's accounting methods rather than true cost reductions. For example, the MTA's first-quarter projected deficit of \$28 million was reduced by \$16 million when the MTA transferred principal and interest expense, net of interest income, originally shown in the operating budget and reflected these adjustments in the debt service fund, a nonoperating fund. While these transfers were effective in reducing the deficit, the MTA will ultimately have to pay these expenses by using MTA operating or capital funds.

The MTA's proposed fiscal year-end adjustments also indicate that it will continue to employ changes in accounting methods in an attempt to reduce the deficit to zero. For example, the

MTA has lowered from \$5,000 to \$2,500 its capitalization policy requirements for assets with a life of one year or more. As a result, instead of reflecting the total expense of the asset in the current fiscal year, this method only recognizes a portion of the total expense each year over the asset's predetermined life. However, these types of changes in accounting methods and transfers do not create actual cost savings. Rather, these methods defer current operating costs to future periods or allocate to nonoperating funds operating expenditures that the MTA must ultimately pay with operating or capital funds.

Events Subsequent to Our Review



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Unaudited data indicates that, as of May 31, 1996, the MTA had an operating deficit of \$3.5 million.
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Subsequent to the end of our field work, on August 8, 1996, the MTA provided us with unaudited financial data of its operating fund for the 11 months ended May 31, 1996. The data were generated using the MTA's new financial information system and reflect actual expenses as of the end of May. While we did not audit this data, it indicates that, as of May 31, 1996, the MTA had an operating deficit of \$3.5 million. However, as stated on page 20, the deficit does not include more than \$16 million in net debt service expenses that were transferred to a nonoperating fund in December 1995.

According to the chief financial officer, the \$3.5 million May deficit will be offset by continued savings in operator salaries as well as making a year-end accrual of revenue. The chief financial officer also stated that the remaining deficit would be eliminated without recording any expenditure adjustments or changes in capitalization policy. Finally, the chief financial officer stated that the accounting changes and expense transfers planned or taken by the MTA are either in conformity with generally accepted accounting principles or are good business practice.

Some Assumptions Underlying the Fiscal Year 1996-97 Budget Are Overly Optimistic

In developing the fiscal year 1996-97 budget, the MTA used various assumptions that included full funding of its operating services at current service levels, except for a segment of the Metro Red Line that began operations in July 1996, and the contracting out of 13 bus lines. The MTA also presupposed other cost reduction strategies, including a reduction in transit operator and maintenance overtime compared to fiscal year 1995-96 levels.


The MTA hypothesized that it will be able to trim operator and maintenance employee overtime by \$10 million during fiscal year 1996-97.


However, we believe some of the assumptions that underlie the MTA's budget may be too optimistic. For example, the MTA hypothesized that it will be able to trim the cost of its operator and maintenance employee overtime by \$10 million during fiscal year 1996-97. The MTA expects that \$5 million of the \$10 million cost reduction will come from a reduction in operator overtime, and \$5 million will be saved by the MTA's reducing the overtime worked by its maintenance employees. For its operators, the MTA anticipated that it could reduce overtime by employing an optimum mix in the number of full-time and part-time operators and contracting with other transit providers to run an additional six of its bus lines by July 1, 1996. Toward that end, the MTA's operations and planning department developed a bus operator staffing plan showing the targeted number of full-time and part-time operator positions to be achieved. However, the documentation supporting the plan provided to us by the MTA lacked sufficient detail for us to assess how it arrived at the targeted \$5 million cost savings. In addition, the transit provider selected to operate six of the MTA's bus lines will not begin operations until sometime in August 1996. Furthermore, no cost analysis information was provided regarding how the MTA plans to reduce the overtime hours among its maintenance employees. For these reasons, we believe that the MTA may have been overly optimistic in its budget assumptions regarding a \$10 million cost savings through reducing overtime.

***Our Review Focused on
Two Components of the
MTA's Budget***

The MTA's fiscal year 1996-97 budget consists mainly of three components:

- An operating budget to account for its bus and rail operations;
- A capital budget to account for rail construction and bus and rail infrastructure; and
- Funds to be distributed to other local transit agencies.


We focused our review on the MTA's operating and capital budgets because those components make up approximately 65 percent of its total budget.

Operating Budget


As shown in Table 5, farebox and other system-generated revenues are budgeted at approximately \$242 million (35 percent of the operating budget). The MTA projected that farebox revenue, which represents approximately 18 percent of all revenue for bus and rail operations, would increase by approximately \$9 million (7.5 percent) over the fiscal year 1995-96 budget, including more than \$8 million related to the opening of a Metro Red Line extension in July 1996.

The MTA derives other operating revenue totaling \$13 million from advertising, leasing, and interest income. The MTA anticipates generating \$500,000 of the \$13 million from its MTA Lite program. This program will use excess capacity at the MTA's Regional Rebuild Center by providing contract maintenance services to other transportation providers. The MTA's Regional Rebuild Center performs major bus repairs, bus system replacement, engine overhauls, major component replacement, and bus painting.

The sources of the MTA's operating revenue include subsidies of approximately \$457 million. These funds are provided by a combined one percent county sales tax authorized by Propositions A and C and state and federal funding. Local sales tax subsidies were budgeted to increase by nearly \$36 million (16.8 percent) over the previous fiscal year based on the August 1995 UCLA business forecast, while the combination of state sales tax and other state funds were budgeted to remain relatively constant compared to the prior fiscal year. In contrast, the MTA's operating budget reflects a decline in federal operating subsidies, and the MTA has assumed that these funds will be phased out completely over the next two years.



The MTA budgeted its fiscal year 1996-97 operating expenses at \$700.8 million, \$42 million over its fiscal year 1995-96 budget levels.



As shown in Table 5, the MTA budgeted its fiscal year 1996-97 operating expenses at \$700.8 million, or \$42 million over its budgeted fiscal year 1995-96 levels. Although the MTA anticipates that it will have contracted out 13 of its bus lines to other companies by the end of August 1996, it anticipates no significant changes in bus service. However, rail service is expected to increase by approximately 30 percent over the prior fiscal year due to the opening of the Metro Red Line extension, which occurred in July 1996. The MTA's fiscal year 1996-97 operating budget includes approximately \$281 million for transit operators' salaries and wages and approximately \$163 million for related fringe benefits that together represent about 63 percent of the total operating expenses budgeted.

Table 5

**Comparison of Budgeted Revenues
and Expenditures Between
Fiscal Years 1995-96 and 1996-97
(In Millions)**


	Fiscal Year		Difference	
	1996-97	1995-96	Amount	Percent
<u>System Revenues</u>				
Farebox	\$125.1	\$116.4	\$ 8.7	7.5%
Other fare	103.5	96.2	7.3	7.6
Other system	13.1	14.4	(1.3)	-9.0
Total system revenues	241.7	227.0	14.7	6.5
<u>Subsidies</u>				
Local sales tax	249.3	213.5	35.8	16.8%
State sales tax	141.9	138.4	3.5	2.5
Other state	19.7	27.9	(8.2)	-29.4
Federal	41.1	44.2	(3.1)	-7.0
Other local	5.3	6.1	(0.8)	-13.1
Total subsidies	457.3	430.1	27.2	6.3
Total Revenues	\$699.0	\$657.1	\$41.9	6.4%
<u>Expenditures</u>				
Salaries and wages	\$280.5	\$277.9	\$ 2.6	0.9%
Fringe benefits	162.6	152.3	10.3	6.8
Services	43.9	27.9	16.0	57.3
Materials and supplies	59.3	62.7	(3.4)	-5.4
Utilities	11.5	13.5	(2.0)	-14.8
Casualty and liability	31.5	28.4	3.1	10.9
Miscellaneous	22.3	15.0	7.3	48.7
Interest expense	19.2	22.4	(3.2)	-14.3
Allocated overhead	70.0	58.7	11.3	19.3
Total Expenditures	\$700.8	\$658.8	\$42.0	6.4%
Surplus/(Deficit)	\$ (1.8)	\$ (1.7)	\$ (0.1)	5.9%

Capital Budget

Budgeted expenditures for the MTA's capital budget for fiscal year 1996-97 total approximately \$1.1 billion, of which \$956 million (84 percent) is allocated for the MTA's rail construction and rail planning projects. Some of the most significant expenditures budgeted for the MTA's rail projects

involve its Metro Red Line. For example, the MTA plans to spend \$280 million for construction on Segment 2, \$334 million for the North Hollywood extension of Segment 3, and \$87 million for the Eastside extension of Segment 3.

The MTA Capital Budget Is Underfunded




Cost overruns in the Metro Red Line Segment 2 required a \$123 million increase in the fiscal year 1996-97 capital budget. In a July 1996 agreement, MTA rescinded the city's obligation to share in the Segment 2 cost overruns in exchange for the city providing \$200 million for Segment 3.




The MTA has encountered problems during the construction of Segment 2 of the Metro Red Line. As a result, the MTA had to request in fiscal year 1995-96 a \$123 million cost revision for the segment to increase, in its fiscal year 1996-97 capital budget, the estimated cost to construct this project. This revision increased the total cost of the project to approximately \$1.64 billion. The cost revision was necessary to reflect a variety of cost overruns. A major portion of the cost overrun, \$66.7 million, is associated with sinkhole problems encountered in constructing this segment of the Metro Red Line. The remaining \$56.4 million of cost overruns is related to other construction activities not originally reflected in the MTA's project budget. Examples of these activities include engineering and construction management costs and the costs for the treatment and disposal of hazardous materials. Despite the \$123 million increase in the MTA's original project budget and a three-month delay in construction projected as of February 1996, the MTA has not changed its estimate of December 31, 1998, as the completion date for this segment of the Metro Red Line.

When we reviewed the sources of funds that the MTA intended to use to pay for the \$123 million in added costs for this segment, we found that approximately \$61.5 million originally was to come from the City of Los Angeles (city) as its share of a cost overrun agreement with the MTA. The cost overrun agreement for this segment contained a maximum commitment by the city to share up to \$90 million in cost overruns with the MTA. However, in July 1996, the MTA and the city entered into a new agreement in which the MTA agreed to rescind the city's \$90 million contractual obligation to contribute to cost overruns encountered for Segment 2 in exchange for the city providing \$200 million in funding for Segment 3.

According to the director of program analysis for the MTA's construction division, the MTA intends to replace the funds that were to come from the city by issuing additional rail bonds that were authorized by Proposition A. However, the MTA's revision of revenue projections for the long-range plan does not reflect the MTA's intention to pay half of the \$123 million



If the bonding capacity is not sufficient for the MTA to issue rail bonds and no other funding sources are available, the Metro Red Line's project costs could increase.



cost overrun with bond revenue. Consequently, the MTA's long-range plan does not reflect the resources necessary to pay more than \$61 million of the \$123 million in added costs. Furthermore, according to a U.S. General Accounting Office report issued in May 1996 on the county rail projects, officials of the MTA acknowledged that if the bonding capacity is not sufficient for the MTA to issue the rail bonds as it intends, and no other funding sources are available, the Metro Red Line's completion schedule will have to be extended and the project's cost could increase.

According to the MTA's construction management, the remaining rail projects have adequate contingency funds to cover unforeseen project delays. Further, the MTA's construction division adopted a cost forecasting policy in September 1995 to identify potential trends and provide timely notification of potential changes to project cost, including the contingency fund and project reserve. The construction division also adopted procedures to control budget changes that same month. The MTA's budget procedures state that, when a project is changed, the revised budget must also include a revised funding allocation plan that is consistent with the rules of the funding source. Nevertheless, the MTA's revised revenue projections for the long-range plan do not reflect more than \$61 million in additional rail project costs.

A Transfer of Funds to Los Angeles County Will Cause Construction Delays

As part of our audit, we reviewed the impact of the MTA's \$50 million transfer of funds to the county. According to an official statement for a bond issuance by the MTA, the MTA's \$50 million transfer of funds to the county will result in a delay of three to five years in the construction of the Metro Blue Line to Pasadena and Segment 3 of the Metro Red Line. Such a delay would almost certainly result in a rise in construction costs for these two projects.

Contingent Liabilities Could Affect the MTA's Financial Condition

The MTA is a defendant in various lawsuits. Although the outcome of these lawsuits is not presently determinable, in the opinion of MTA's management, the resolution of these matters will not have a materially adverse effect on the MTA's financial condition.

Our review of the MTA's contingent liabilities included lawsuits over \$100,000 and their estimated loss potential. As of June 30, 1996, the estimated loss potential from lawsuits related to Metro rail construction projects ranges from \$3 million to \$9 million. Of this amount, up to \$8 million concerns the Metro Red Line. In addition, three other pending lawsuits related to the Metro Red Line are in the early stages of litigation. Thus, their outcome or the MTA's estimated loss potential is not presently determinable. The MTA had reserved approximately \$12 million for contingent capital project liabilities as of February 29, 1996.

Conclusion

By using the MTA's actual costs of transit operations recorded during the first half of 1995-96 and annualizing these costs for the last part of the fiscal year, we determined that the MTA exceeded its revised operating budget by approximately \$14 million.

The MTA's plan to reduce its projected mid-year deficit to zero by year-end was not realistic based on the revenue and expense trends we reviewed. Specifically, the MTA's more significant cost reduction strategies involved changing the MTA's accounting methods or removing certain expenses from its operating budget and reclassifying them as expenses of a nonoperating fund; these strategies did not result in true cost savings. The majority of the MTA's deficit reduction plan involved deferring current operating costs to future periods and allocating current operating expenses to nonoperating funds. Nevertheless, the MTA will ultimately pay these expenses with operating or capital funds.

We believe that, for fiscal year 1996-97, the MTA may have developed its budget by using some overly optimistic assumptions, such as the significant cost savings it expects to achieve by reducing employee overtime.

Finally, the MTA identified approximately \$123 million in unbudgeted cost overruns relating to one of its rail projects in fiscal year 1995-96. While it considered the additional costs in formulating its fiscal year 1996-97 budget, the MTA has yet to provide in its current long-range plan a means to pay for half of these costs.

Chapter 3

The MTA's Plan for Managing Its \$3 Billion Outstanding Debt Complies With Prescribed Limits

Chapter Summary

The debt management plan of the Los Angeles County Metropolitan Transportation Authority (MTA) calls for a continued increase in its debt over the next several years as the MTA constructs a rail and highway transportation system. Although its debt is extensive, the MTA's plan for managing its debt service program nonetheless complies with prescribed limits imposed by its trustees for bond issues. In addition, to achieve a net present value savings of at least 3 percent, the MTA issues bonds to refund outstanding bonds only when interest rates decline. Finally, since June 1995, an MTA management policy has required that the MTA base its debt decisions on its financial advisor's cost-benefit analyses and recommendations for the most prudent courses of action. However, we did not confirm that the MTA has consistently enforced this requirement.

As of June 30, 1996, the MTA's outstanding long-term debt was approximately \$3.1 billion, and over the remaining term of the debt it will pay interest totaling approximately \$2.9 billion. As of June 1996, the MTA also had approximately \$179 million in outstanding short-term debt, consisting of approximately \$149 million in tax-exempt commercial paper and \$30 million in revenue anticipation notes that are due to be paid during fiscal year 1996-97.

Currently, the MTA plans to issue bonds totaling over \$2 billion during the next several fiscal years to finance its rail and highway construction projects. To achieve cost savings over the term of the debt, the MTA also plans to continue issuing bonds to refund previous ones. The MTA proposes to issue, before the end of 1996, bonds totaling \$200 million to fund various construction projects, and it plans to issue refunding bonds totaling \$260 million.

***The MTA's Outstanding Debt Totaled
More Than \$3 Billion as of June 30, 1996***

As shown in Table 6, the MTA's outstanding long-term debt as of June 30, 1996, was approximately \$3.1 billion, and over the remaining term of the debt it will pay interest totaling approximately \$2.9 billion. As of June 1996, the MTA also had approximately \$149 million of tax-exempt commercial paper and \$30 million of revenue anticipation notes outstanding that are due to be paid during fiscal year 1996-97.

Table 6

***MTA Annual Long-Term
Debt Service Obligation
(In Millions)***

Due in Fiscal Year	Principal	Interest	Total
1996-97	\$ 52.3	\$ 171.7	\$ 224.0
1997-98	57.1	174.8	231.9
1998-99	62.7	170.8	233.5
1999-00	68.0	166.9	234.9
2000-01	76.5	162.6	239.1
Thereafter	2,808.5	2,099.1	4,907.6
Total	\$3,125.1	\$2,945.9	\$6,071.0

Debt service represents approximately 22 percent of the MTA's annualized fiscal year 1995-96 operating expenditures, up from 19 percent in the previous fiscal year.

In its budget, the MTA identified its operating expenditures as those expenditures that supported its operations, including debt service expenditures. However, our review of the MTA's fiscal year 1995-96 interim financial statements was limited to those documents related to its bus and rail operations; these operations do not include debt service and other operating expenditures. Thus, when we calculated the percentage of debt service expenditures to its annualized fiscal year 1995-96 operating expenditures, we included in the calculation its annualized bus and rail, debt service, and other operating expenditures. As a result, debt service represents approximately 22 percent of the MTA's annualized fiscal year 1995-96 operating expenditures, up from 19 percent in the previous fiscal year. This percentage is based on debt service of approximately \$206 million and projected annualized operating expenditures of approximately \$948 million. The debt service requirements exclude interest related to commercial paper and revenue anticipation notes, which amount to \$15.6 million.

The MTA Plans To Increase Its Outstanding Debt Service

Before the end of 1996, the MTA plans to issue \$200 million in bonds to fund construction projects and \$260 million in bonds to refund previously issued bonds.

The MTA believes that its plan for managing debt must provide the transportation system mandated by the voters with the passage of Propositions A and C. To fulfill this mandate, the MTA plans to issue bonds over the next several years and to construct a rail and highway transportation system that meets the transit needs of the county's residents. The MTA currently plans to issue bonds totaling approximately \$2 billion over the next several years, and it proposes to issue bonds totaling \$200 million before the end of 1996 to fund various construction projects. In addition, to achieve a net present value savings over the life of the bonds, the MTA plans to continue issuing bonds, including \$260 million within the next few months, to refund previously issued bonds.

The MTA's Plan for Managing Its Debt Service Program Falls Within Prescribed Limits

Based on our review, the MTA's plan for managing its debt service program complies with the following criteria:

- Prescribed limits imposed by the MTA's trustees for bond issues; and
- Self-imposed limits that require the MTA to issue new bonds to refund outstanding bonds only when a net present value savings of at least 3 percent can be achieved.

In addition, the MTA has required since June 1995 that it base its debt decisions on its financial advisor's cost-benefit analyses and recommendations for the most prudent courses of action for all current and future bond issues. However, we did not confirm that this requirement has been consistently enforced.

The MTA issues bonds and other debt in various categories that are dependent on the revenues pledged as the source of principal repayment. The MTA has identified these categories in order of priority:

- First tier senior obligations, which include some of the Proposition A sales tax revenue bonds;

- First tier second senior obligations, which include lease revenue bonds and Proposition C sales tax revenue bonds;
- Second tier obligations, which include some Proposition A sales tax revenue refunding bonds, housing bonds, redevelopment bonds, and taxable commercial paper; and
- Third tier obligations, such as tax-exempt commercial paper.

In addition, the MTA has other long-term obligations, which include general revenue bonds and certificates of participation, as well as revenue anticipation notes, which provide short-term funding for current operations.

The MTA's trustees and fiscal experts require agreements to guarantee the payment to secure the bonds, certificates of participation, and commercial paper. These agreements permit the MTA to issue additional bonds within the various debt categories. However, before it issues additional bonds, the MTA often is required to obtain certification from a consultant that the revenues it has pledged as the source of principal repayment for the debt equal or exceed one or more predetermined debt service coverage ratios. These ratios, which are generally more conservative for the MTA in comparison to other transit agencies, vary depending on the bonds outstanding when additional bonds are issued. Use of the ratios serves to limit the amount of outstanding debt after the bonds are issued. The consultant performs tests, known as "additional bonds" tests, to certify the MTA's compliance with the ratios required by various agreements.

The consultant certified that the MTA complied with the various agreement requirements in the four outstanding bond issues we reviewed.

The MTA's consultant certified that the MTA complied with the various agreement requirements in all four outstanding bond issues we reviewed for which additional bonds tests were required. For example, in June 1996, when the MTA issued first tier bonds that pledged Proposition A sales tax revenues to repay debt and second tier refunding bonds to pay off outstanding commercial paper, the consultant performed five additional bonds tests required by four trustee agreements for outstanding bonds. The consultant certified compliance with the following ratios:

- At least 35 percent of the Proposition A sales tax collected for any 12 consecutive months out of 15 consecutive months prior to the issuance equaled at least 115 percent of the maximum annual debt service for all bonds and similar debt that will be outstanding after the bonds are issued.

- At least 75 percent of the Proposition A sales tax collected for any 12 consecutive months out of 15 consecutive months preceding the issuance equaled at least 125 percent of the total maximum annual debt service as defined by the trust agreement.
- At least 40 percent of the Proposition A sales tax collected for any 12 consecutive months out of 15 consecutive months preceding the issuance equaled at least 125 percent of the total maximum annual debt service for all nonrail debt that will be outstanding after the bonds are issued.
- The pledged revenues collected for any 12 consecutive months out of 15 consecutive months prior to the issuance equaled at least 130 percent of the maximum total annual debt service for all senior bonds and similar obligations that will be outstanding after the bonds are issued.
- Pledged revenues collected for any 12 consecutive months out of 18 consecutive months immediately preceding the issuance equaled at least 100 percent of the maximum total annual debt service for all bonds and other specified debt that will be outstanding immediately after the issue.

When it issues new bonds to refund outstanding bonds, the MTA also requires that the refunding bonds be issued only when interest rates decline to a point where it can achieve a net present value savings of at least 3 percent. As a result, the MTA can achieve a cost savings over the term of the debt when there is a significant decline in interest rates.

A July 1996 refunding bond issue will provide a \$26 million savings in debt service costs over the term of the debt.

We reviewed three refunding bond issues and verified that the MTA achieved a 3 percent net present value savings on each one. For example, the MTA issued bonds in July 1996 totaling approximately \$186 million to refund the outstanding debt of bonds that it issued in January 1995. According to the MTA's financial consultant, the refunding will provide a \$26 million (15 percent) savings in debt service costs over the term of the 29-year debt.

An MTA management policy has required since June 1995 that its financial advisor document the relevant information for all current and future bond issue transactions. This information includes a cost-benefit analysis that identifies potential short-term and long-term savings or increased revenue to the MTA, the impact of the issuance on the MTA's debt capacity, alternative strategies to generate potential savings and increased

revenue, and the financial advisor's recommendation for the most prudent course of action considering the cost-benefit analysis. However, we did not confirm that the MTA has consistently enforced the requirement.

Finally, the MTA plans to implement a formal long-term debt policy during fiscal year 1996-97 that identifies its financial standards for debt service. According to a draft of the policy, these standards will ensure that the MTA's debt assumptions are consistent with or more conservative than the requirements placed on it by financial markets. In addition, the financial standards will ensure that the MTA's management will be able to monitor its debt program effectively.

Chapter 4

The MTA's Bus System Improvement Plan Needs Further Development

Chapter Summary

The board of directors (board) for the Los Angeles County Metropolitan Transportation Authority (MTA) adopted the Bus System Improvement Plan (bus plan) on March 27, 1996, to evaluate and improve bus service for the transit customers of Los Angeles County (county) over a five-year period. Although the MTA adopted the bus plan almost five months ago, it has yet to develop some of its key components. While the MTA has identified cost estimates for portions of most key components of the bus plan totaling \$76 million, cost estimates are still not available for some projects that support these components. Also, while implementation of most key components is scheduled to begin during fiscal year 1996-97, a few projects still have no set time line. Another key component, improved security, is pending approval by the board.

The board authorized the allocation of \$10.4 million of fiscal year 1996-97 Proposition C discretionary funds to improve countywide service on overcrowded lines, but funding sources to relieve overcrowding in future years must be approved annually by the board. The MTA also expects to fund other components of the bus plan with future Proposition C sales tax revenues, state and federal grants, and redistribution of existing resources, but the specific dollar amounts for most components have not been appropriated in the budget.

Certain Factors Led to the Development of the Bus Plan

Certain factors led the board to realize that to remain competitive in an aggressive marketplace, the MTA must improve its bus system. A proposed change in its fare structure during the summer of 1994 triggered a civil rights class action complaint against the MTA. Also, during a workshop conducted by the MTA in September 1995 and attended by members of the Bus Riders Union, MTA staff indicated that the MTA was experiencing a decline in peak fleet and ridership.

“Peak fleet” refers to the maximum number of buses scheduled to pick up transit customers between the hours of 6:00 and 9:00 a.m. and between 3:00 and 6:00 p.m. on weekdays. Based on these factors, the board directed its staff in September 1995 to develop a plan that would provide ongoing improvements to the bus system.

According to the minutes of a January 1996 board meeting, a motion was introduced on behalf of the mayor of Los Angeles, who is a member of the board, directing MTA staff to augment the bus plan with specific costs, schedules, objectives, and performance measures that describe improvements to be made to the bus system from the customers’ perspective. The board approved and adopted the bus plan on March 27, 1996.

***The MTA Has Not Identified Cost
Estimates and Time Lines for Some
Key Components of the Bus Plan***


Although the MTA adopted the bus plan almost five months ago, some of its key components still need further development. The bus plan is comprised of the following six key components: crowding relief and more frequent service, mobility improvements, security, pricing and fare collection, service quality improvements, and customer focus. While the MTA has identified cost estimates totaling approximately \$76 million for portions of most projects that support the key components of the bus plan, cost estimates are not available for some projects. For example, cost estimates for the customer relations training program, transit security, fare structure development, schedule reliability, public information, and the transit radio system are still unknown. These projects were adopted by the MTA to implement the key components of the bus plan.

Implementation of a majority of the bus plan’s key components is scheduled to begin in fiscal year 1996-97, but a few projects still have no time lines for implementation, such as the transit radio system project and customer focus, which is a key component of the bus plan. In addition, fare structure development is pending the outcome of a lawsuit, and the plan to improve transit security has been delayed pending further studies.


The Bus Plan Is Not Fully Funded

The board has only allocated \$10.4 million of fiscal year 1996-97 Proposition C funds to support one of the plan’s key

components established to improve overcrowding on bus lines throughout the county. Service on countywide lines is provided by various transit operators, with the MTA being the largest. The MTA expects to receive \$7.9 million of the \$10.4 million Proposition C discretionary revenues for fiscal year 1996-97; the remaining revenues will be divided among the county's smaller transit operators. All transit operators are required to allocate these funds to services that will relieve overcrowding for transit customers. For fiscal year 1997-98 and thereafter, funds to alleviate overcrowding will be approved by the board on an annual basis.



The MTA's board adopted a policy in June 1996 to dedicate revenues above its budget assumptions to bus system improvement, but the MTA has not yet identified the plan components for which these revenues will be used.



The MTA expects to fund other components of the bus plan with future Proposition C sales tax revenue, state and federal grants, and redistribution of existing revenues. To date, the MTA has estimated costs of \$76 million related to its bus plan. Currently, the specific dollar amounts for most of the components have not been appropriated in the budget. According to the minutes of a board meeting held on June 26, 1996, the board adopted a policy that all Proposition A and Proposition C sales tax, farebox revenue, Transportation Development Act, and State Transit Assistance revenues generated by the MTA above its fiscal year 1996-97 budget assumptions should be dedicated to bus system improvement. However, the MTA has not yet identified the bus plan components for which these revenues will be used. In addition, the MTA has experienced difficulties in balancing its budget during the past two fiscal years, so additional revenues above its existing budget assumptions may not be available.

The Components of the Bus Plan Need Further Development

With the bus plan, the MTA seeks to look at its existing bus service delivery system and identify ways to improve service. The main goals are to understand the bus riders' priorities for mobility needs and provide an effective and efficient range of customer-driven services. The bus plan also places a high emphasis on affordability, safety, security, quality, convenience, comfort, and reliability. The overall aim is to improve service quality.

To improve service quality, the bus plan states that the MTA must establish better lines of communication within the various communities and incorporate service planning based on the individual needs of the communities that rely on bus service. In addition, the bus plan stipulates that the MTA must examine new types of services through restructuring studies and redistribute fiscal resources acquired through various cost-saving

projects such as service contracting. To address all of these concerns, the MTA has created an action plan comprised of the following key components:

- **Crowding Relief and More Frequent Service:** The Bus Operations Subcommittee met to determine methodologies to relieve overcrowding on certain routes used by transit customers. The subcommittee concluded that there are no pertinent indicators to develop countywide standards for customers most in need of transit service since customers exist all over the county and their trip patterns cover numerous service areas. Overcrowding can be reduced if the MTA provides more buses to increase passenger seating capacity. Three projects the MTA has established to implement this key component include reducing overcrowding, service contracting, and reviewing loading standards. With these projects, the MTA plans to introduce limited-service buses and add more local service to existing crowded bus lines.

To further reduce overcrowding, the MTA has also contracted out seven bus lines to other transit providers, and it is in the process of awarding a contract for the outside operation of six more of its bus lines. The MTA plans to redistribute to other bus service improvement projects the cost savings anticipated from such contractual arrangements. The MTA has estimated an operating cost savings of \$24.3 million from these service contracts. However, the MTA has yet to establish cost estimates to review loading standards.

- **Mobility Improvements:** The MTA seeks to obtain a better understanding of the community's mobility needs so as to offer more efficient transportation options that will reduce passenger travel time. The options considered by the MTA include taxi vouchers, smaller vehicles that run on demand, and smart shuttles. A "smart shuttle" is a vehicle used for multiple services to decrease operating costs. Under the smart shuttle program, taxis and vans of various sizes will run on flexible routes to accommodate passenger requests, thereby filling the gap between automobile and fixed-route transit buses. In conjunction with the City of Los Angeles Department of Transportation, and the Southern California Association of Governments, the MTA has established a smart shuttle demonstration project. Its purpose is to test the operational, technological, and marketing alternatives of the smart shuttle concept under current market conditions.

The MTA will also conduct pilot projects to install bus preference signals and arterial bus lanes. Bus preference signals give priority to transit buses over other traffic at key signalized intersections. These programs seek to improve bus speeds.

- **Security:** The bus plan states that, to enhance transit services effectively, the MTA must improve security and the perception of safety along its bus lines. Because the bus system police commonly deal with assaults, pickpockets, panhandlers, and unruly passengers, the MTA needs to focus on the security needs of its passengers and employees. During its April 1996 meeting, the board adopted a resolution to approve in concept a merger of the MTA Transit Police Department (MTAPD) with the Los Angeles Police Department (city police) and the Los Angeles County Sheriff's Department (county sheriff). The MTA contends that this partnership will deliver the highest quality law enforcement and security services with the combined skills and capabilities of the MTAPD, city police, and county sheriff. However, during its July 24, 1996, meeting, the board delayed its decision on the merger and formed an ad hoc committee comprised of city, county, and transit officials. Many questions were raised at the meeting regarding overhead and wage rates for city police and county sheriffs, the number of sworn officers to patrol the Metro Blue Line rail system, and liability issues. This key component of the bus plan needs further development before implementation is possible.
- **Pricing and Fare Collection:** The MTA is currently conducting various studies with other transit operators in the county that could lead to the implementation of a fare collection system that uses advanced technology. However, in August 1994, a civil rights class action complaint was filed against the MTA. Temporary fare increases effective February 1995 were allowed by court order, but long-term changes in the fare structure will be decided after the outcome of the lawsuit is determined at the trial in October 1996. As a result, until the case is decided, implementation is not possible.
- **Service Quality Improvements:** MTA management believes that the quality of the contact its employees establish with the public greatly influences the public's view of the transit system. The MTA staff who are in regular contact with the public include transit operators, customer service representatives, road supervisors, and information clerks. To improve the public's image of the MTA's bus service, the

bus plan seeks to improve the quality of its customer services. The MTA has adopted several strategies to meet this goal, including implementing a training program to assist MTA staff in treating customers professionally, cultivating an understanding of basic customer needs, and developing the skills necessary to handle the most common customer complaints.

The MTA also plans to install transit radio systems in MTA vehicles to allow for better tracking of vehicles to improve on-time performance. However, the MTA has yet to develop cost estimates for the transit radio system program.

- **Customer Focus:** To better understand the needs of its community, the MTA plans to improve interaction with transit users and nonusers. Such interaction will give the community a chance to help the MTA develop and implement a range of new transit services that will meet the community's needs. The MTA is currently considering two concepts that would create transit improvement councils as well as a transit-improvement council forum. The MTA has not developed cost estimates and set time lines for this component of the bus plan.

The MTA Has Incomplete Transit System Performance Measures

Because we could obtain complete data for only 6 months of an 18-month time frame, we could not review performance trends.

Because the MTA had incomplete data for several portions of the 18-month period between January 1995 and June 1996, we were unable to review performance trends over this time period. We requested transit system performance measures for January 1995 through June 1996; however, we were only able to obtain complete data measuring efficiency, effectiveness, and reliability for July through December 1995. For January through June 1995 and for January through June 1996, only fragmented data were available. Operating cost and farebox revenue data representing the MTA's results of operations were not available for January through June 1996 because the MTA was in the midst of transitioning to a new financial information system. However, for January through June 1995, the MTA was unable to provide us with operating cost and farebox revenue data that specifically identifies the bus system component using its prior financial information system. Furthermore, the MTA provided complete data to us only for one performance indicator, customer complaints, for January 1995 through March 1996. Thus, we were able to review the trend of complaints for 15 months, but unable to establish trends for any performance measures over the 18-month period.


Our review of complaint data for January 1995 through March 1996 revealed that the number of complaints increased significantly in July, August, and September 1995, and again in December 1995 through March 1996. According to a senior budget analyst for the MTA, as of June 1995, several MTA buses that had methanol engines had mechanical problems and broke down frequently. To mitigate this, the MTA started replacing old buses with methanol engines with buses that used compressed natural gas. However, this created additional problems because the MTA did not have trained personnel to maintain the new buses or new facilities to service the buses. As a result, transit customers complained about a decline in the MTA's service quality and reliability.

Conclusion

The MTA has not fully developed and identified funding for its bus plan. Although it has developed some of the key components for its bus plan, the MTA has not identified the costs of some of the projects that support these components. Furthermore, some projects have no set time frames and another project, improved security, has not been approved by the board. The MTA has allocated \$10.4 million to improve countywide services on overcrowded lines, but the board must approve annually any future funding for overcrowding.

We conducted this review under the authority vested in the state auditor by Section 8543 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,


for KURT R. SJOBERG
State Auditor

Date: August 28, 1996

Staff: Doug Cordiner
Russ Hayden
Christiana Mbome
Greg Saul, CPA
Virginia Veneracion-Alunan



August 22, 1996

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Dear Mr. Sjoberg:

Enclosed are the MTA's comments on your report, entitled "Los Angeles County Metropolitan Transportation Authority: Planning and Budgeting of its Operations and Bus Plan Need Improvement".

The MTA strongly disagrees with the conclusions of this report. The conclusions are not supported by facts or the actual results of operations. Our comments are as follows:

①*

1. The Report is flawed in its findings with respect to MTA's Long Range Plan and Budget.
 - a) The financial update is only the first phase of the biannual Long Range Plan process. The update report is used to highlight issues for the Board to review in the reassessment process. The latest financial information will be incorporated into the reassessment of the Long Range Plan, culminating with the readoption of the Plan by the Board of Directors in the Spring of 1997. The MTA will emphasize the maintenance and improvement of bus service in the reassessment.
 - b) All adjustments in project costs and schedules, including the \$61 million referenced in the report, will be reflected in the reassessment. This information was not known at the time the financial update report was written. This adjustment will impact FY1997-98 and MTA has the capacity in its Proposition A Rail Bonds to cover this additional expense. This adjustment will not impact bus service.

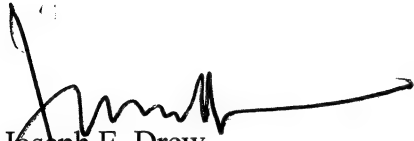
*The California State Auditor's comments on this response begin on page 63.

- c) The MTA uses the UCLA forecast because it most closely reflects the Los Angeles County economy and is regarded as a conservative planning forecast. The UCLA Business Forecasting Project is a recognized leader in econometric forecasting. MTA uses this forecast for projecting sales tax revenues and inflation factors. Local sales tax revenues account for almost 40% of the total revenues over the twenty-year period in the Financial Update.
 - d) The FY1995-96 and FY1996-97 Budgets are balanced. The report misinterpreted a FY1995-96 mid year report on a projected \$14 million budget shortfall. This shortfall was mitigated by June 30, 1996. Therefore, the report projects a \$1.3 billion shortfall over 20 years based on a misinterpretation of the data. In addition, any accounting adjustments in the budget were based upon Generally Accepted Accounting Principles (GAAP) and reflected proper recording of both revenues and expenses, consistent with MTA's fiscal policies. ②
 - e) Bus efficiencies have been accomplished. ③
 - The reorganization of Operations was accomplished in FY1994-95, not FY1995-96 as reported.
 - The overtime reductions in FY1995-96 due to alignment of full and part time operators were realized by June 1996. These savings were incorporated in the FY1996-97 Budget.
 - The Board allocated \$10.4 million in the FY1996-97 Budget for the Bus System Improvement Plan (BSIP) to relieve overcrowding in the transit dependent areas.
 - The Board adopted the policy to reserve any funds in excess of the FY1996-97 Budget for the Bus System Improvement Plan.
2. MTA concurs with the conclusions of the Report that MTA's debt management plan also complies with MTA's Fiscal Policy.
3. The adoption of the Bus System Improvement Plan in March 1996 reinforced MTA's commitment to bus improvements throughout the region. As referenced above, the Board approved an initial commitment of \$10.4 million with an ongoing commitment to improve and expand bus service.

Kurt R. Sjoberg
August 22, 1996
Page 3

The four attachments contain line by line corrections to assertions made in this report. **Attachment 1** contains the summary of our conclusions as detailed in this letter. **Attachment 2** relates to Chapter 1 - the Long Range Plan . **Attachment 3** relates to Chapter 2 on the Budgeting Process. **Attachment 4** relates to Chapter 4 on the Bus System Improvement Plan. We have no comments on Chapter 3 on the Debt Management Plan.

Sincerely,

A handwritten signature in black ink, appearing to read 'Joseph E. Drew', with a long horizontal flourish extending to the right.

Joseph E. Drew
Chief Executive Officer
Los Angeles County Metropolitan
Transportation Authority

Attachments

A:\mjw\reportletter.doc

Summary of MTA's Comments on the Report

entitled "Los Angeles County Metropolitan Transportation Authority: Planning and Budgeting of its Operations and Bus Plan Need Improvement".

The MTA strongly disagrees with the conclusions of this report. The conclusions are not supported by facts or the actual results of operations. Our comments are as follows:

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 - a) The financial update is only the first phase of the biannual Long Range Plan process. The update report is used to highlight issues for the Board to review in the reassessment process. The latest financial information will be incorporated into the reassessment of the Long Range Plan, culminating with the readoption of the Plan by the Board of Directors in the Spring of 1997. The MTA will emphasize the maintenance and improvement of bus service in the reassessment.
 - b) All adjustments in project costs and schedules, including the \$61 million referenced in the report, will be reflected in the reassessment. This information was not known at the time the financial update report was written. This adjustment will impact FY1997-98 and MTA has the capacity in its Proposition A Rail Bonds to cover this additional expense. This adjustment will not impact bus service.
 - c) The MTA uses the UCLA forecast because it most closely reflects the Los Angeles County economy and is regarded as a conservative planning forecast. The UCLA Business Forecasting Project is a recognized leader in econometric forecasting. MTA uses this forecast for projecting sales tax revenues and inflation factors. Local sales tax revenues account for almost 40% of the total revenues over the twenty-year period in the Financial Update.
 - d) The FY1995-96 and FY1996-97 Budgets are balanced. The report misinterpreted a FY1995-96 mid year report on a projected \$14 million budget shortfall. This shortfall was mitigated by June 30, 1996. Therefore, the report projects a \$1.3 billion shortfall over 20 years based on a misinterpretation of the data. In addition, any accounting adjustments in the budget were based upon Generally Accepted Accounting Principles (GAAP) and reflected proper recording of both revenues and expenses, consistent with MTA's fiscal policies.

②

e) Bus efficiencies have been accomplished.

- The reorganization of Operations was accomplished in FY1994-95, not FY1995-96 as reported.
- The overtime reductions in FY1995-96 due to alignment of full and part time operators were realized by June 1996. These savings were incorporated in the FY1996-97 Budget.
- The Board allocated \$10.4 million in the FY1996-97 Budget for the Bus Service Improvement Program (BSIP) to relieve overcrowding in the transit dependent areas.
- The Board adopted the policy to reserve any funds in excess of the FY1996-97 Budget for the BSIP.

2. MTA concurs with the conclusions of the Report that MTA's debt management plans also complies with MTA's Fiscal Policy.
3. The adoption of the BSIP in March 1996 reinforced MTA's commitment to bus improvements throughout the region. As referenced above, the Board approved an initial commitment of \$10.4 million with an ongoing commitment to improve and expand bus service.

The four attachments contain line by line corrections to assertions made in this report. Attachment 1 contains the summary of our conclusions as detailed in this letter. Attachment 2 relates to Chapter 1 - the Long Range Plan . Attachment 3 relates to Chapter 2 on the Budgeting Process. Attachment 3 relates to Chapter 4 on the Bus Service Improvement Program. We have no comments on Chapter 3 on the Debt Management Plan.

ATTACHMENT 2:

Response to the Draft State Auditor Report
Chapter 1 : Long Range Plan
prepared by: M.J. West

Page 1-1 Chapter Summary - Paragraph 2

1. \$351 million anticipated funding gap reported represents 0.5% of the total projected revenues in the \$68 billion Financial Update Board report.
2. The report states that “\$1.1. billion in projected cost savings was based on a flawed assumption leaving only \$1.2 billion in true cost savings”. This statement is incorrect on two points:
 - MTA staff never characterized the variance between the adopted Long Range Plan and the Update as “savings”;
 - The Plan is characterized as ‘flawed’ because information from the FY 1995-96 Budget is incorporated in the development of the Financial Update Board Report dated February 1996. The auditors incorrectly assumed the budget figure used in the update was incorrect. This is further discussed in the section described under page 1-8, Item #3. (4)
3. The report states “a funding shortfall of more than \$755 million over the life of the plan”. The report does not provide any back-up support for that figure in order to substantiate the finding. In fact, MTA staff cannot recreate how the number was calculated nor find any reference in any of the tables. (5)
4. MTA staff do not agree with the finding of a \$1.3 billion funding gap and cannot recreate the number. (6)

Page 1-4

1. The report states that “pending litigation prohibiting MTA from fully implementing its fare structure forced reductions in projections of farebox” revenues of \$1.966 billion. There were no events **forcing** a reduction in the farebox revenue assumption. MTA staff chose to forecast revenues based on the current structure, only allowing for increase in inflation, as a worst-case scenario. MTA staff could have assumed resolution of the lawsuit and implementation of the proposed fare structure. (7)

Page 1-5 First Paragraph

1. MTA assumed a phase-out of Section 9 Operating Funds through FY 1997 -98 based on historical allocations of operating federal funds, resulting in a projected decrease of \$686 million in operating revenues over the twenty year period. More recent DOT

Budget information suggests that the federal operating subsidy will not be phased out and will remain at current funded levels, at least through FY 2002. Therefore, in the upcoming reassessment period, an increased projection for this revenue source will be assumed, thus mitigating or negating the prior assumption of a phase-out of federal operating funds.

Page 1-5 Second Paragraph

1. The MTA did change a “significant assumption” in the projection of federal ISTEA revenues, which MTA characterizes as an improvement in estimation methodology. Revenue projections for federal ISTEA revenues, including Section 9 Capital funds, CMAQ and STP, were tied to the growth in the Highway Trust Fund. This was reported in the Financial Update Board Report.
2. Furthermore, the Report incorrectly states that “the UCLA Business Forecasting Project ... forecasts average inflation rates for a period of 20 years into the future”. UCLA provides annual inflation factors. MTA staff utilize 10-year averages for inflation factors to smooth out any anomalies in the data.

8

Page 1-5 Third Paragraph

1. The Report states that “As a result of adjusting the inflation rate assumptions for capital projects down from 3.28 percent to 2.68 percent, rail capital transit improvement funds are projected to decrease by \$386 million.” This statement is misleading. The reduced inflation factors produced lower outyear construction cost estimates for the three rail lines beyond MOS-3. MTA is assuming a 50% federal contribution on these projects, based on historical contribution rates. Therefore, if costs are estimated to decrease, the federal contribution should decrease. This was reported in the Financial Update Board Report.

Page 1-5 Fourth Paragraph

1. The Report incorrectly states that “the MTA increased its estimate of revenues ... such as local sales tax...”. The projections for Proposition A and C sales tax revenue were based on the UCLA Forecast. The MTA did not increase its estimate of local sales tax revenues. The Financial Update reported a **decrease of \$279 million** from the adopted Long Range Plan.
2. Furthermore, the report incorrectly includes labels to attach to the variance in revenue projections such as “actual dollars lost” and “changes in the projected inflation rate and forecasting methodology”. MTA believes there is no distinction in the revenue projection variances as reported in the Financial Update Board Report. The report reflected a \$3.6 million reduction in projected revenues based on revised assumptions and forecasting methodology.

9

10

Page 1-6 Table 2

1. Table 2 on page 1-6 is incorrect and misleading. The estimation methodology for all federal ISTEA revenues was changed in the update to reflect the growth rate of in the federal Highway Trust Fund. This chart is incomplete because it only shows selective data. MTA believes there is no distinction in the revenue projection variances as reported in the Financial Update Board Report. The report reflected a \$3.6 million reduction in projected revenues based on revised assumptions and forecasting methodology.

(11)

Page 1-6 First Paragraph

1. The first statement of this section connotes an action that is untrue. MTA **did not** “act to mitigate the projected decrease in plan revenues through reductions in the projected costs of rail and bus operations, capital projects, and funding for local transit agencies”. When the Board adopted the Long Range Plan on March 22, 1995, the guiding recommendations included an annual financial update. As stated in the Financial Update Board Report dated February 1996, the update did not change MTA priorities, commitments, or modal emphasis. It included:
 - known changes to economic projections,
 - refined estimates of project costs,
 - the updated FY 1995-96 Budget information, and
 - and any known Board actions since March 1995.
2. In fact, in the absence of revised cost estimates, many of the capital cost projections did not change in the update. The bus capital component of the Long Range Plan remained unchanged from the Long Range Plan, as did most of the cost estimates for rail and highway construction projects. Staff used the latest information available for bus operations, which included the FY 1995-96 Budget for MTA and the FY 1996 - 1999 Short Range Transit Plans for the Municipal Operators.
3. The statement “an additional \$398 million in projected cost savings depends on the MTA increasing the amount of times between trains, which could effectively lower the level of rider service” is misleading. MTA staff undertook a cost containment effort when the Long Range Plan was adopted. It was through this effort that the rail operating plans were found to include excess capacity for the projected ridership. This resulted in minor adjustments to the rail operating plans, which reduced cost projections by \$398 million over the twenty year period. Contrary to statements included in the audit, these changes to the rail operating plans do not affect projected ridership, since MTA staff reduced the excess capacity of the rail system to match projected demand.

(12)

(13)

4. The statement “the MTA financial update projects cost savings of \$2.3 billion of which \$2 billion reflects the 20-year projected cost efficiencies anticipated from bus operations and maintenance” is incorrect. The update report did not classify the variance between the adopted Long Range Plan and the Financial Update as “cost savings”. (14)
5. The report states “However, the assumption used by the MTA in projecting these efficiencies was flawed” . This statement is incorrect as detailed below in Page 8, Item #3. (12)

Page 1-7 - Table 3

1. There is a fundamental error in Table 3 in that it does not add across. The numbers on the left are put into classifications created by the auditors, however, the four right hand columns do not add up to the amount in the far left column. (15)
2. Furthermore, MTA does not agree with the categorization of the variances and the labeling. MTA believes all revenue variances are due to changes in assumptions and/or improvements to the estimation methodology. The analysis of the cost variances understates the reduction due to the change in inflation assumption by not including bus operations. The auditors chose to classify the \$2.3 billion variance in bus operations to “efficiencies” . Additionally, the auditors were given correct information to break out MTA from the other regional operators and to correctly break out the inflation impacts, which they did not choose to use. (16)

Page 1-8 First paragraph

1. At no time did the MTA’s manager of long range planning claim the variance in bus operating projections between the Adopted Long Range Plan and the Financial Update were “projected bus operating efficiencies”, as stated in the Report. The Financial Update incorporated the latest information available to highlight issues for the Board. The cost projections for MTA bus and rail operations were based on the information provided in the FY 1995-96 Budget. (17)
2. There are two incorrect assumptions in the statement “Although the fiscal year 1995-96 budget cost reduction strategies were not met, the MTA did not revise its bus projections accordingly”:
 - The Financial Update Board report was given to the Board in February 1996. The fiscal year does not end until June 30, 1996. Therefore, staff would not have known the year-end results in February 1996. (18)
 - The report incorrectly assumes the FY 1995-96 budget included cost reduction strategies that were not met. This statement is incorrect on two points which are discussed further in the next section.

3. The report incorrectly assumed that the MTA FY 1995-96 Budget was “predicated on a cost reduction strategy to reduce operator salaries and fringe benefits through the elimination of 272 positions and reorganize the MTA bus operations into regional divisions”. In fact, the MTA eliminated 272 vacant management and maintenance positions through a regional reorganization effort that occurred in FY 1994-95. These reductions were then reflected in the FY 1995-96 Budget. Furthermore, the auditors were given fiscal-year end data that showed that FY 1995-96 actuals were in line with the FY 1995-96 Budget. (4)

Page 1-8 Second Paragraph

1. The report labels the UCLA forecast as “overly optimistic” based on the following reasoning process: “The 1995 UCLA forecast shows that the actual average inflation factor for the 15 years preceding the plan year (1981 to 1995) was 4.22 percent”. While this may be true, historical inflation rates are not a predictor of future inflation factors. (19)
2. Furthermore, the UCLA Business Forecasting Project is a recognized leader in econometric forecasting. They have provided seminars and briefings to the State Senate, State Assembly, and the Chiefs of Staff of the California Legislature in 1995 and 1996. The use of the UCLA Forecast for projecting sales tax revenues and inflation factors is appropriate for the Long Range Plan.
3. The report states that the “revisions to the long-range plan still result in a funding shortfall of more than \$755 million over the life of the plan”. The report does not include any back-up support for that figure in order to substantiate the finding. In fact, MTA staff cannot recreate how the number was calculated nor find any reference in any of the tables. (5)

Page 1-8 Third paragraph

1. MTA does not agree with the classification that “only \$1,224.9 can be tied to real dollars, obtained primarily through increasing the time between trains that could result in a lower level of rider service”. A classification of “real” when given to twenty-year projections is meaningless. The Long Range Plan and the financial update report were developed using the most current and conservative financial assumptions. As explained to the auditors, some of the assumptions will be revised favorably to the MTA in the upcoming Long Range Plan reassessment process. (13)
2. The Report states that some of the “real dollars” saving will be “obtained partially through a reduction in rider service”. The Report further states in the same paragraph that there may be “a possible reduced level of service”. These statement are made in relation to the changes in the rail operating cost projections discussed above. The Report incorrectly assumes a cause- and-effect relationship between reduced (13)

operating cost projections and service levels. As explained above under Page 1-6, Item #3, MTA reduced excess capacity in the rail operating plans to match ridership projections in the cost containment effort.

13

Page 1-9 Conclusion - First Paragraph

1. The MTA anticipates that the pending litigation related to the proposed fares will be settled favorably for the MTA. As explained to the auditors, the Financial Update Board report contained the worst-case assumption related to farebox revenues which is not likely to materialize. Therefore, it is more likely fare revenue projections will be increased in the reassessment process of the Long Range Plan.
2. Furthermore, the Financial Update included a worst-case assumption that the federal operating revenues may be phased out over the next few years, based on information received at the time the report was developed. Subsequently, the MTA has received information that projects federal operating subsidies remaining at current funded levels, thus mitigating or possibly negating a projected operating revenue reduction of \$686 million over the life of the plan.
3. The statement that “In an effort to mitigate the loss of revenues, the MTA revised its projections of operating costs based on planned efficiencies in operations and maintenance...” is completely erroneous. This statement implies that MTA revised its cost projections in response to mitigate revenue losses. The implied sequence of events is incorrect, based on the following:
 - MTA began its cost containment effort immediately after the 1995 Long Range Plan was adopted, based on Board mandate,
 - The Board of Directors approved the FY 1995-96 Budget in July 1995,
 - MTA received the 1995 UCLA Forecast for sales tax revenues and inflation factors and the federal funding earmarks in September 1995,
 - The financial capacity analysis was completed in November 1995,
 - The Financial Board Report was then written and presented to the Board in February 1996.

12

Response to the Draft State Auditor Report
Chapter 2: The MTA's Budgeting Process
prepared by Ronny J. Goldsmith

Page 2-1 Paragraph 1 and 2.

1. The FY 94-95 Budget was balanced as a result of (1)a management reorganization including the elimination of 212 unfilled budgeted management positions and 60 maintenance positions and (2) the use of one time revenue. These actions were necessary because of a court order which prevented the implementation of the fare structure upon which the FY 94-95 Budget was predicated. As part of the FY95-96 Budget, a plan was implemented to eliminate the reliance on one time revenue to balance the operating budget. The FY96-97 Budget which is balanced, relies on no one time revenue. (4)
2. MTA projected a balanced FY96 budget based upon the implementation of a bus operator hiring plan in September 1995 and the actual results of operations through May 31, 1996. (2)
3. The reduction in operator salaries in the FY96 Budget is the result of contracting out of 7 bus lines and reducing the number of full time operators accordingly to reflect the mix of part-time and full time operators required by the FY96 bus operator optimization model.
4. The FY96 Budget is balanced based on actual results of operations through May 31, 1996. Any accounting adjustments in the budget were based upon Generally Accepted Accounting Principles(GAAP) and reflect the proper recording of both revenues and expenses consistent with MTA fiscal policies. (2)
5. Reductions in the cost of workers compensation claims as well as other liabilities is the result of Best Practices plans implemented as early as July 1995 to reduce overhead costs and thereby increase the funds available for MTA bus operations and is not the result of accounting adjustments.

The actuarial valuations upon which the Workers Compensation and Public Liability accounts are based will be revised based upon two independently performed actuarial studies. Any reduction in liability accounts will be based upon actual experience.

6. It is the policy of the MTA to capitalize the cost of certain inventory items. This is consistent with MTA fiscal policy as well as good business practices. The balanced FY96 Budget is not predicated on any change in capitalization policy. (2)
7. The change in accounting for the Certificates of Participation had no effect on the ending fund balance of the operating fund . Non-operating expenses and related revenues that were budgeted in the operating fund were reclassified and accounted for as expenses of a non-operating fund in accordance with GAAP and in concurrence with the recommendation of Coopers and Lybrand, MTA's Independent Auditors. Interest earnings and interest expense related to the issuance of Certificates of Participation were both reclassified. This had no effect on the ending fund balance of any fund including the operating fund. (2)

Page 2.1 -Paragraph 3.

1. No carryover deficit is projected from the FY96 operating budget. The optimum number of full and part time operators included as part of the FY97 Budget assumptions were in place as of June 1996, one month ahead of schedule. (2)

Page 2.2 -Paragraph 1

1. The FY97 Budget is based on an operator staffing model which determines the number of full and part time operators required to minimize cost at planned service levels. The savings in overtime is a result of this staffing model and not the result of unrelated cost reductions. MTA operated at these operator levels during the months of June and July 1996.

Page 2.2 -Paragraph 2

1. The additional capital costs associated with the Red Line Segment 2 are not included in the FY97 capital budget because (1) the FY97 budget was adopted prior to the Red Line funding plan being approved by the Board of Directors and (2) it has no impact on the FY97 operating or capital budget. The current expenditure plan forecasts the need for approximately \$86M of the \$123M in FY98.

Page 2.3 Paragraph 2

1. MTA is projecting a balanced FY96 Budget.

2

Fare box revenue is projected to be under budget by \$2M in FY96. This represents only 2% of total projected fare box receipts of \$211M and is more than offset by increases in other revenue sources.

2. In accordance with GAAP and with the concurrence of Cooper's and Lybrand, MTA's Independent Auditors, MTA changed the accounting treatment related to a Worker's Compensation Financing to allow for revenue related to the financing to be recorded in the same fund where the related expense occurs and was done to comply with Generally Accepted Accounting Principles.

Page 2.4 Paragraph 1

1. The increase in bus operator wages and overtime is a result of the delay in contracting out 7 lines and the related increase in cost to MTA to provide the level of service included in the FY96 Budget. A bus operator hiring plan was implemented in September 1995 which resulted in a significant reduction in these costs during the last six months of FY96.

An aggressive cost reduction strategy was implemented in FY94-95. This resulted in an FY 94-95 ending fund deficit of less than \$2M. The actual results of the strategy were taken into consideration in the formulation of the FY95-96 Budget.

4

2. The savings from the reduction of 212 vacant non-contract and 60 maintenance positions was realized in FY94-95. The FY 95-96 Budget was developed after these positions had been eliminated and the savings realized. Further more, the reorganization of bus divisions into regional divisions had no impact on operator salaries and fringe benefits.
3. MTA spent \$3M more on vehicle parts in FY96 than budgeted. This increase in expense is directly related to the level of service provided by MTA during FY96.

4

4. There was a non-recurring inventory adjustment equal to approximately \$1.5M in December, 1995. Annualizing December 1995 results overstates projected operating expenses by \$1.5M. In addition, in FY 96, a new heavy maintenance program was implemented which was budgeted based on the capitalization of \$3.5M in parts as required by the grant funding program. The year to date December 1995 operating results do not reflect capitalizing these parts. The capitalization of bus parts is in conformance with MTA Policy and good business practice.

Page 2.4. Paragraph 2

1. In September 1995, MTA projected a balanced FY96 budget based upon the September 1995 implementation of a bus operator hiring plan.
2. Both the cost and the revenue associated with the certificates of participation were transferred from the enterprise fund to the debt service fund. This has no affect on the ending balance of either fund. (20)
3. It is MTA's policy to reconcile actual results of cost allocation with budgeted costs quarterly. This does not reflect a change in budgetary approach nor is it a strategy to balance the FY96 operating budget.

Page 2.4 Paragraph 3.

1. MTA's Plan to reduce its projected deficit to zero is realistic based upon the actual results of operations through May 1996. An analysis of the data supplied as part of this audit clearly demonstrates this. The actual results of operations through May 1996 do not include any changes in expense accounting methods. (2)
2. Both revenue and expense related to the certificates of participation have been transferred from the enterprise fund to the debt service fund. The was done to comply with GAAP; and is not a strategy to balance the FY96 budget. It has no impact on the ending balance of either the operating or the debt service fund. (20)

Page 2.4 Paragraph 4

1. MTA has not used any "accounting methods" to balance the FY96 Budget. Accounting adjustments in the budget were based upon Generally Accepted Accounting Principles and reflect the proper recording of both revenues and expenses consistent with MTA Fiscal Policy.

Page 2.5 Paragraph 1

1. The impact of capitalization is to realize the cost of inventory over the life of the inventory. This is consistent with MTA policy and good business practice.

Page 2.5 Paragraph 2

1. Using May 31, 1996 year to date results of operations, it is projected that MTA will have a balanced operating budget at year end. This is in no way impacted by the transfer of \$16M of both debt service revenues and expenses to a non-operating fund to comply with Generally Accepted Accountd Principals. (2)
(20)

Page 2.5. Paragraph 3

1. Based upon the results of operations as of May 31, 1996, it is projected that the MTA will end FY 96 with a balanced operating fund. Any accounting adjustments were based on Generally Accepted Accounting Principles and reflect the proper recording of both revenues and expenses.

2

Page 2.5. Paragraph 5

1. The assumptions upon which the FY97 Budget are based are very conservative. The number of full and part-time operators assumed in this budget were in place as of June 1996.

Page 2.6 Paragraph 1

1. MTA achieved the optimum number of operators to provide FY97 service levels as of June 1996. The savings in operator salaries and overtime included in the FY97 budget will materialize based upon current operator staffing levels.
2. The savings realized as a result of the reduction in operator overtime is based upon the FY97 bus operator model which determines the number of full time and part time operators as well as related overtime cost required to provide FY97 service levels. This is the standard transportation industry method of determining operator wages and overtime.
3. The FY97 Budget included \$1.5M in operator salaries to cover any cost related to a delay in contracting out service lines through September 1996. A delay through August will not result in an operating deficit as stated but will result in year end savings.
4. Cost analysis information regarding how maintenance overtime was reduced was provided by MTA as part of this audit. Maintenance overtime has been reduced as a result of unfreezing budgeted maintenance positions. With the additional number of full time maintenance employees and the related straight time expense, overtime has been reduced. The straight time expense is included in the FY97 Budget.
5. FY97 Budget assumptions are conservative. The assumptions are supported by the actual results of FY96 operations and take into consideration any potential delay in the implementation of alternative service delivery.

2

Page 2.7 Paragraph 3

1. The FY97 Budget assumes a growth of up to 11% in local sales tax subsidies based upon the September 1995 UCLA forecast. This increase in revenue will be credited to the Special Revenue Fund. Current sales tax subsidies as well as balances from prior years which are programmed to be spent in future years are held in this fund.. The FY97 Budget assumes a 16.8% increase in the programmed use of local sales tax subsidies.

Page 2.7 Paragraph 4

1. The FY97 Budget included \$1.5M in operator salaries to cover any cost related to a delay in contracting out service lines through September 1996. A delay through August will not result in an operating deficit as implied but will result in year end savings.

Page 2.9 Paragraph 4.

1. The \$123M in additional funds required for Segment 2 completion is included in the Long Range Plan update currently in progress. This is the first update of the Long Range Plan since it was determined that the project would be over budget.
2. The additional bond funds required to complete the Red Line Segment 2 as a result of the anticipated increase in project costs is also included in the Long Range Plan update. It was not included in the FY97 capital budget because (1) the FY97 budget was adopted prior to the funding plan being approved by the Board of Directors and (2) it has no impact on the FY97 operating or capital budget. The current expenditure plan forecasts the need for approximately \$86M of the \$123M in FY98.

21

Page 2-10 Paragraph 1

1. The Long Range Plan update that is in progress includes the \$123M in additional funds required for Segment 2 completion. Furthermore, Segment 2 completion is the number 1 priority for Proposition A 35% rail development funds.

Page 2.11 Paragraph 3

1. The MTA's plan to reduce its projected midyear deficit to 0 was realistic based upon the actual results of operations through May 31, 1996 which represents 11 out of 12 months of operations.
2. Based upon actual results of 11 months of operations, the MTA's FY96 Budget is balanced. The most significant cost reduction strategy in FY 97 was the implementation of an operator staffing plan in September 1995. This plan produced real savings in operator wages during the last six months of FY96 and which are continuing in FY97.
4. The effect of the MTA's deficit reduction plan was to produce real time on-going operating savings prior to any accounting adjustments required by Generally Accepted Accounting Procedures.

2

2

Page 2.11 Paragraph 4

1. MTA used conservative FY97 budget assumptions based on the actual results of operations in FY96. The optimum number of operators to provide FY97 budgeted service levels was in place in June and July 1996. In addition, \$1.5M was included in the FY97 Budget to cover any costs related to a possible delay in contracting out service through September 1995. Based on MTA's continued ability to meet its operator requirement levels, the budgeted reduction in operator overtime assumed in the FY97 budget will be realized..

**Response to the Draft State Auditor Report
Chapter 4: The MTA's Bus Service Improvement Program
prepared by Jim McLaughlin**

Page 4 -1 Paragraph 1 and 2

1. The tone of these paragraphs is to focus on the negative aspects of some of the timing and funding for the Bus System Improvement Plan. (22)

This could easily be redrafted to give the MTA credit for developing a comprehensive plan, establishing a new \$10.4 million annual program to relieve overcrowding for the transit dependent and establishing a mechanism to fund more BSIP improvements if revenues exceed budget projections.

2. Other funding should also include redistribution of resources referenced on page 4-3 in paragraph 4. (23)

Page 4-2 Paragraph 3 and 4

1. Again the tone is negative focusing on apparent lack of action. However, for example, as noted the transit security issue is held pending Board action (a special ad hoc committee will meet September 13) and the fare structure is tied to the litigation. (22)
2. It is erroneous, for example, to focus on no timelines for customer focus since the service planning market research projects is proceeding on schedule which will provide us with preliminary data to assist in the development of the Transit Improvement Councils. (24)

Page 4-2 Paragraph 5, Page 4-3 Paragraphs 1 and 2

1. Once again the \$10.4 million is framed as only when in reality these were the only new operating funds in the budget and were all allocated to bus improvements.
2. As indicated previously, funding should include the redistribution of resources on page 4-3 paragraph 4. (23)
3. The statement in paragraph 2 regarding failure to balance the budget has already been proved inaccurate. Therefore, it appears more likely that more funds will be available for BSIP as indicated in the prior sentence, which again states the commitment of the Board to provide funding for bus services. (2)

Page 4-3 Paragraphs 1 and 2

1. Instead of entitling this section with the negative of needing more development, it could easily have been worded to give credit to the MTA for developing an innovative program that seeks to be more customer oriented and work smarter to make current resources go further.

22

Page 4-4 Paragraphs 1 and 2

1. To be factual, the MTA staff report on relieving overcrowding for the transit dependent recommends three actions:
 - a demonstration program on two lines to decrease the loading standard from 1.45 (62 persons) to 1.10 (47 persons) increasing service quality.
 - a demonstration program on two lines to implement new limited stop service to augment existing local service increasing capacity and travel speed.
 - additional service on 11 lines to reduce overcrowding.
2. The primary goal of the current contracted service is to reduce operating costs and thus make additional resources available for bus service.
3. The last sentence, regarding loading standards, relates more directly to a review of the Consolidated Transit Service Policies, another BSIP project that will begin after an evaluation of the demonstration projects referenced above.

25

Page 4-5 Paragraph 1

1. Although the MTA fare structure is the subject of litigation, working on a coordinated fare collection process, including the use of technology, is not impacted and is proceeding.

Page 4-6 Paragraph 2

1. The Transit Radio System has been installed on 950 buses, or approximately one-half of the fleet. Future funding for the remaining buses is available pending evaluation of Phase One.

Page 4-6 Paragraph 3

1. All data including operating costs and fare box revenue to determine performance measures are available for the time frames in question.

26

Page 4-6 Paragraph 4 and Page 4-7 Paragraph 1

1. To be factual, the Board approved the purchase of 100 new methanol/ethanol engines. An additional 100 methanol/ethanol engines will be rebuilt for the cost of materials. The vendor will absorb the labor costs. New vehicles also approved by the Board will operate with CNG (145 had arrived as of July 31, 1996 and 141 of those were in operation as of that date). Another 149 CNG buses are scheduled to arrive over the next six months. A new order of 250 CNG buses will be scheduled for production to be completed in calendar year 1998. (25)

Funds have been budgeted to install a new CNG fueling station at Division 18 in Carson to complement the three divisions (8, 10, and 15) now servicing CNG vehicles.

Page 4-7 Paragraph 2

1. Again, instead of giving credit for developing the BSIP and working actively towards implementation the tone is negative. Citing the \$10.4 million as requiring annual approval is indicative of the focus on the negative minutia instead of discussing the benefits of this new funding source. (22)

Comments

California State Auditor's Comments on the Response From the Los Angeles County Metropolitan Transportation Authority

To provide clarity and perspective, we are commenting on the Los Angeles County Metropolitan Transportation Authority's (MTA) response to our audit report. The following numbers correspond to the numbers we have placed in the MTA's response.

- ① Our report is fully supported by the facts, and the conclusions reached are based on those facts provided to us by the MTA.
- ② We did not misinterpret the fiscal year 1995-96 mid-year report. Our report is based on the best evidence available at the time of our fieldwork, which projected a \$14 million shortfall. Further, the MTA's own assessment of this data generated a \$13.8 million shortfall. The MTA now asserts that the budget shortfall has been eliminated. However, the MTA's assertion is based on unaudited data through May 1996 that we received on August 8, 1996, after the end of our fieldwork. In addition, the MTA mistakenly believes that our projected \$14 million shortfall was used in deriving the \$1.3 billion shortfall in the long-range plan.
- ③ As stated on page 36, we recognized and included the \$10.4 million in our analysis of the Bus System Improvement Plan. However, for the other "efficiencies" referred to in its response, the MTA was unable to provide any information supporting its assertions.
- ④ The MTA stated in the introduction to its fiscal year 1996-97 budget dated May 30, 1996, that the \$20 million cost reduction strategy never materialized. On August 22, 1996, the MTA stated that the reorganization took place in fiscal year 1994-95. However, when we requested documentation to support this statement, the MTA could not provide it to us. Refer to Comment 2 for our comments regarding the fiscal year 1995-96 actual data.

- ⑤ The \$755 million would be the MTA's shortfall over the life of the plan if inflation rates change as they expect. As reflected in Table 3 on page 13, if \$540.6 million is subtracted from \$1,296.3 million, the result is \$755.7 million.
- ⑥ The \$1.3 billion is shown in Table 3 on page 13 as \$1,296.3 million.
- ⑦ Text changed.
- ⑧ Contrary to the MTA's assertion, on page 17 in Appendix B of UCLA's August 1994 report, the Consumer Price Index inflation rate is projected for a span of 20 years from 1995 to 2014.
- ⑨ The MTA is in error. In fact, as stated on page 11 of our report, it did increase its estimate of other revenues by a net amount of \$131 million. While local sales tax revenues did not increase, other state and miscellaneous revenues did increase.
- ⑩ We used these terms to distinguish where the MTA projected that actual cuts would be made as contrasted to merely lowering a future inflation rate.
- ⑪ We cannot understand how the MTA finds this table incorrect or misleading since it replicates a table in its own financial update for the long-range plan.
- ⑫ Our statement is neither incorrect nor erroneous. It is based upon a report submitted to the MTA's board of directors dated February 6, 1996, prepared by the manager of long-range planning and the director of strategic funding analysis. This report states that the MTA's budget was reduced in recognition of lower revenues caused by reduced farebox revenues and federal funding.
- ⑬ The MTA seems to equate "rider service" with "ridership." In our report, we state that the level of rider service could be lowered if train departure times are delayed.
- ⑭ We do not believe that there is a distinction between "cost savings" and "cost efficiencies." Therefore, throughout our report, we use these terms interchangeably.
- ⑮ Table 3 on page 13 of our report is not erroneous. It is meant to be read from left to right.
- ⑯ Contrary to the MTA's contention, we did not ignore the impact of inflation on the \$2.3 billion variance. In fact, it is discussed on page 14 of our report.

- ⑪ The MTA is incorrect. On July 19, 1996, the MTA's manager of long-range planning stated that these were operating cost efficiencies.
- ⑫ As cited in the report to the board of directors dated January 8, 1996, the MTA was aware that the projected cost efficiencies related to its bus operations would not be realized.
- ⑬ Text changed.
- ⑭ Despite its contention, the MTA could not furnish us with information to substantiate that the amount of revenues transferred out of the operating fund equaled the amount of expenses transferred. As stated on pages 20 and 21 of our report, the expenses transferred, net of income, totaled more than \$16 million.
- ⑮ The MTA is incorrect. As stated on pages 25 and 26 of our report, although the MTA intends to issue additional rail bonds to replace the funds that were to come from the City of Los Angeles, this funding is not reflected in its long-range plan.
- ⑯ We believe that the tone of our report appropriately addresses the conditions that we found during our audit.
- ⑰ Text changed.
- ⑱ We think that good project planning includes setting time lines for all projects, even those dependent on other projects.
- ⑲ Our report is factual. We chose to paraphrase the more technical aspects related to the Bus System Improvement Plan.
- ⑳ If this data is available for its transit system, the MTA withheld it from us because we repeatedly requested this information.

cc: Members of the Legislature
Office of the Lieutenant Governor
Attorney General
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps